"AZERBAIJAN RAILWAYS" CLOSED JOINT STOCK COMPANY

The International Financial Reporting Standards Consolidated Financial Statements and Independent Auditors' Report

For the Year Ended December 31, 2016

"AZERBAIJAN RAILWAYS" CLOSED JOINT STOCK COMPANY

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STATEMENT OF MANAGEMENT'S RESPONSIBILITIES FOR THE PREPARATION AND APPROVAL OF THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2016

The following statement is made with a view to distinguish respective responsibilities of the management and those of the independent auditors in relation to the International Financial Reporting Standards ("IFRS") consolidated financial statements of "Azerbaijan Railways" Closed Joint Stock Company ("ADY" or the "Company") and its subsidiaries (collectively referred to as the "Group").

Management is responsible for the preparation of the consolidated financial statements that present fairly the financial position of the Group as at December 31, 2016, the results of its operations, changes in equity and cash flows for the year then ended, in accordance with International Financial Reporting Standards ("IFRS").

In preparing the consolidated financial statements, management is responsible for:

- Selecting suitable accounting principles and applying them consistently;
- Making judgments and estimates that are reasonable and prudent;
- Stating whether IFRS have been followed, subject to any material departures disclosed and explained in the consolidated financial statements; and
- Preparing the consolidated financial statements on a going concern basis, unless it is inappropriate to presume that the Group will continue in business for the foreseeable future.

Management is also responsible for:

- Designing, implementing and maintaining an effective and sound system of internal controls throughout the Group;
- Maintaining proper accounting records that disclose, with reasonable accuracy at any time, the consolidated financial position of the Group, and which enable them to ensure that the consolidated financial statements of the Group comply with IFRS;
- Maintaining statutory accounting records in compliance with the applicable legislation and accounting standards;
- Taking such steps that are reasonably available to them to safeguard the assets of the Group; and
- Detecting and preventing fraud, errors and other irregularities.

The consolidated financial statements of the Group for the year ended December 31, 2016 were authorized for issue on September 28, 2017 by the Management of the Company.

On behalf of the Management:

Javid Gurbanov
General Director

September 28, 2017
Baku, the Republic of Azerbaijan

Fuad Safarov
Head of Finance and Economy department

September 28, 2017
Baku, the Republic of Azerbaijan

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INDEPENDENT AUDITORS' REPORT

To the Management of "Azerbaijan Railways" Closed Joint Stock Company:

Qualified Opinion

We have audited the consolidated financial statements of "Azerbaijan Railways" Closed Joint Stock Company ("ADY" or the "Company") and its subsidiaries (together referred to as the "Group"), which comprise the consolidated statement of financial position as at December 31, 2016, and consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended and a summary of significant accounting policies and other explanatory notes.

In our opinion, except for the effects of the matters described in the Basis for Qualified Opinion paragraph, the accompanying consolidated financial statements present fairly, in all material respect, the financial position of the Group as at December 31, 2016 and its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs).

Basis for Qualified Opinion

Although we have participated in the annual counting process of inventory balances of the Group for 2016, which was held during August and September of 2016, we were not able to obtain inventory movement per items from the count date to the end of the year. Additionally, we were not able to observe the counting process of inventory balances for prior years, since the dates of annual inventory count were prior to our engagement acceptance dates. We also were unable to satisfy ourselves by alternative means concerning the quantity of inventory held as at December 31, 2016 and 2015, which were stated in the consolidated statement of financial position at AZN 58,089 thousand and AZN 41,069 thousand, respectively. As a result of this matter we were as well unable to determine whether any adjustment might have been found necessary in respect of recorded or unrecorded inventories, and the elements presented in the consolidated statement of comprehensive income, statement of changes in equity and cash flows.

As described in Note 17 to the consolidated financial statements, as at December 31, 2016 the Group was not in compliance with certain covenants stipulated in the borrowing agreements signed with International Bank for Reconstruction and Development, BNP Paribas (Suisse) S.A., HSBC Bank plc, Credit Suisse AG, VTB Bank (the Republic of Austria), Cargill Financial Services International Inc., Ceska Sporitelna S.A. and Ceskoslovenska Obchodni S.A.

Breach of these covenants may result in early withdrawal of funds by the lenders and therefore, these borrowings should be classified as current. According to the representations of the management, although the Group has breached number of covenants imposed by the agreements mentioned above, the risk of early withdrawal of funds is remote and these borrowings should be classified according to their contractual repayment schedules, rather than current liabilities. We were not able to obtain appropriate and sufficient audit evidence to support management's representations and consequently, we were unable to satisfy ourselves regarding appropriateness of classification of these borrowings between current and non-current categories.

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the Auditors' Responsibilities for the Audit of the Consolidated Financial Statements section of our report. We are independent of the Group in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code), and we have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified opinion.

Responsibilities of Management and Those Charged with Governance for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with IFRS, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Group or to cease operations, or have no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Group's financial reporting process.

Auditors' Responsibilities for the Audit of the Consolidated Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control;
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control;
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management;

- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern; and
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

Baker Tilly Azerbaijan

September 28, 2017
Baku, the Republic of Azerbaijan

CONSOLIDATED STATEMENT OF FINANCIAL POSITION
AS AT DECEMBER 31, 2016

(In thousands of Azerbaijani Manats unless otherwise indicated)

	Notes	December 31, 2016	December 31, 2015
ASSETS			
Non-current assets:			
Property, plant and equipment	8	2,957,499	2,498,506
Intangible assets	9	420	444
Prepayment for property, plant and equipment	10	325,114	188,314
Deferred tax asset	11	3,102	-
Total non-current assets		**3,286,135**	**2,687,264**
Current assets:			
Inventories	12	58,089	41,069
Loans receivable	13	60,817	77,581
Trade and other receivables	14	31,562	66,160
Cash and cash equivalents	15	147,757	8,119
Other current assets	16	65,216	44,880
Total current assets		**363,441**	**237,809**
TOTAL ASSETS		**3,649,576**	**2,925,073**
LIABILITIES AND EQUITY			
LIABILITIES:			
Non-current liabilities:			
Deferred tax liability	11	-	66,393
Long-term borrowings	17	1,351,483	733,911
Finance lease obligations	18	74,921	81,829
Trade and other payables	19	175,075	158,320
Other non-current liabilities	20	22,822	27,790
Total non-current liabilities		**1,624,301**	**1,068,243**
Current liabilities:			
Short-term borrowings	17	522,393	224,952
Finance lease obligations	18	21,633	15,502
Trade and other payables	19	221,612	190,859
Taxes payable other than income tax	21	10,871	15,365
Income tax payable		165	1,659
Advances received	22	138,324	139,675
Salaries payable		7,294	6,230
Other current liabilities		407	538
Total current liabilities		**922,699**	**594,780**
Total liabilities		**2,547,000**	**1,663,023**

CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT DECEMBER 31, 2016 (Continued)

(In thousands of Azerbaijani Manats unless otherwise indicated)

	Notes	December 31, 2016	December 31, 2015
EQUITY:			
Share capital	23	726,147	726,147
Government investments	24	946,205	607,098
Accumulated loss		(539,567)	(42,265)
Currency translation reserve		(14,872)	(12,904)
Other reserve		(16,026)	(16,026)
Equity attributable to equity holders of the parent		**1,101,887**	**1,262,050**
Non-controlling interests		689	-
Total equity		**1,102,576**	**1,262,050**
TOTAL LIABILITIES AND EQUITY		**3,649,576**	**2,925,073**

On behalf of the Management:

Javid Gurbanov
General Director

September 28, 2017
Baku, the Republic of Azerbaijan

Fuad Safarov
Head of Finance and Economy department

September 28, 2017
Baku, the Republic of Azerbaijan

The notes on pages 12-76 form an integral part of these consolidated financial statements.

"AZERBAIJAN RAILWAYS" CLOSED JOINT STOCK COMPANY

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED DECEMBER 31, 2016

(In thousands of Azerbaijani Manats unless otherwise indicated)

	Notes	Year ended December 31, 2016	Year ended December 31, 2015
Revenues			
Cargo revenues		261,573	203,407
Construction revenues	25	61,913	31,930
Passenger revenues		13,164	12,131
Other revenues	26	26,384	29,161
Total revenues		**363,034**	**276,629**
Operating expenses			
Depreciation and amortization	8,9	(157,600)	(132,632)
Wages, salaries and related contributions		(68,907)	(67,589)
Material, repairs and maintenance		(14,123)	(29,207)
Electricity costs		(13,217)	(17,573)
Construction costs	25	(63,091)	(37,848)
Taxes other than income tax	27	(21,994)	(19,239)
Fuel expenses		(7,022)	(7,603)
Washing cost of bedding sets		(786)	(1,111)
Rent expenses		(2,805)	(8,226)
Bank commissions		(5,808)	(5,160)
Other operating costs	28	(15,077)	(11,945)
Total operating expenses		**(370,430)**	**(338,133)**
Other income/(expense)			
Bad debt expense	29	(81,550)	(117,575)
Foreign exchange loss		(190,421)	(447,399)
Loss on impairment of property, plant and equipment		(229,386)	(205,455)
Loss on damaged and obsolete inventory	12	(70)	(1,012)
Loss on disposal of property, plant and equipment		(713)	-
Loss on disposal of intangible assets		-	(203)
Finance costs	30	(64,710)	(36,071)
Gain on bargain purchase		653	-
Other income, net	31	7,957	4,722
Loss before income tax		**(565,636)**	**(864,497)**
Income tax benefit	11	68,950	171,129
Net loss for the year		**(496,686)**	**(693,368)**
Other comprehensive loss			
Other comprehensive loss to be reclassified to profit or loss in subsequent periods - Exchange differences on translation of foreign operations		(1,968)	(12,904)
TOTAL COMPREHENSIVE LOSS FOR THE YEAR		**(498,654)**	**(706,272)**

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED DECEMBER 31, 2016 (Continued)

(In thousands of Azerbaijani Manats unless otherwise indicated)

	Notes	Year ended December 31, 2016	Year ended December 31, 2015
Attributable to:			
Equity holders of the parent		(499,270)	(706,272)
Non-controlling interests		616	-
TOTAL COMPREHENSIVE LOSS FOR THE YEAR		**(498,654)**	**(706,272)**

On behalf of the Management:

Javid Gurbanov
General Director

September 28, 2017
Baku, the Republic of Azerbaijan

Fuad Safarov
Head of Finance and Economy department

September 28, 2017
Baku, the Republic of Azerbaijan

The notes on pages 12-76 form an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED DECEMBER 31, 2016

(In thousands of Azerbaijani Manats unless otherwise indicated)

	Share capital	Government investments	Retained earnings/ (Accumulated loss)	Currency translation reserve	Other reserve	Non-controlling interests	Total equity
January 1, 2015	**726,147**	**523,061**	**651,103**	-	-	-	**1,900,311**
Government investments during the year	-	84,037	-	-	-	-	84,037
Effect of business combination (Note 2)	-	-	-	-	(16,026)	-	(16,026)
Total comprehensive loss for the year	-	-	(693,368)	(12,904)	-	-	(706,272)
December 31, 2015	**726,147**	**607,098**	**(42,265)**	**(12,904)**	**(16,026)**	**-**	**1,262,050**
Government investments during the year	-	339,107	-	-	-	-	339,107
Contribution in share capital of subsidiaries by non-controlling shareholders	-	-	-	-	-	73	73
Total comprehensive loss for the year	-	-	(497,302)	(1,968)	-	616	(498,654)
December 31, 2016	**726,147**	**946,205**	**(539,567)**	**(14,872)**	**(16,026)**	**689**	**1,102,576**

On behalf of the Management:

Javid Gurbanov
General Director

September 28, 2017
Baku, the Republic of Azerbaijan

Fuad Safarov
Head of Finance and Economy department

September 28, 2017
Baku, the Republic of Azerbaijan

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"AZERBAIJAN RAILWAYS" CLOSED JOINT STOCK COMPANY

CONSOLIDATED STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2016
(In thousands of Azerbaijani Manats unless otherwise indicated)

	Notes	Year ended December 31, 2016	Year ended December 31, 2015
CASH FLOWS FROM OPERATING ACTIVITIES:			
Loss before income tax		(565,636)	(864,497)
Adjustments for non-cash items:			
Depreciation and amortization	8,9	157,600	132,632
Loss on impairment of property, plant and equipment		229,386	205,455
Finance costs	30	64,710	36,071
Bad debt expense	29	81,550	117,575
Change in provision for warranties		3,831	8,808
Change in provision for damaged and obsolete inventory		70	1,012
Change in provision for loss on construction contracts		(13,079)	(11,241)
Foreign exchange loss		190,421	447,399
Other income, net		(10,066)	(4,722)
Gain on bargain purchase		(653)	-
Loss on disposal of intangible assets		-	203
Loss on disposal of property plant and equipment		713	-
Cash flows from operating activities before changes in operating assets and liabilities		**138,847**	**68,695**
Changes in operating assets and liabilities			
(Increase)/decrease in operating assets:			
Change in inventories		(14,972)	(445)
Change in trade and other receivables		(4,061)	(4,992)
Change in other current assets		(19,140)	14,555
Increase/(decrease) in operating liabilities:			
Change in trade and other payables		(23,227)	40,023
Change in advances received		(5,868)	44,690
Change in taxes payable other than income tax		(5,318)	(29,578)
Change in salaries payable		1,049	(214)
Change in other current liabilities		(500)	331
Net cash inflow from operating activities		**66,810**	**133,065**
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchase of property, plant and equipment		(312,832)	(288,789)
Net investments in loans receivable		(4,852)	(55,712)
Purchase of a subsidiary, net of cash acquired		682	-
Purchase of intangible assets		(82)	(390)
Net cash used in investing activities		**(317,084)**	**(344,891)**
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from borrowings		324,513	309,039
Repayment of borrowings		(112,974)	(125,123)
Proceeds from government investments		214,366	29,253
Interest received		1,949	-
Interest paid		(43,395)	(32,296)
Contribution in subsidiaries by non-controlling shareholders		73	-
Net cash inflow from financing activities		**384,532**	**180,873**

CONSOLIDATED STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2016 (Continued)

(In thousands of Azerbaijani Manats unless otherwise indicated)

		Year ended December 31, 2016	Year ended December 31, 2015
Effect of foreign exchange differences on cash and cash equivalents		5,380	2,011
NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS		139,638	(28,942)
CASH AND CASH EQUIVALENTS, *at the beginning of the year*	15	8,119	37,061
CASH AND CASH EQUIVALENTS, *at the end of the year*	15	147,757	8,119

Non-cash transactions

The principal non-cash transactions during the year ended December 31, 2016 included acquisition of property, plant and equipment items through direct payment of government of the Republic of Azerbaijan and other fund providers to the third parties under the loan agreements in the amount of AZN 124,741 thousand and AZN 534,652 thousand, respectively (2015: acquisition of property, plant and equipment items through direct payment of fund providers to the third parties under the loan agreements in the amount of AZN 91,277 thousand and through finance lease agreement in the amount of AZN 50,114 thousand).

On behalf of the Management:

Javid Gurbanov
General Director

September 28, 2017
Baku, the Republic of Azerbaijan

Fuad Safarov
Head of Finance and Economy department

September 28, 2017
Baku, the Republic of Azerbaijan

The notes on pages 12-76 form an integral part of these consolidated financial statements.

1. THE GROUP AND ITS OPERATIONS

Corporate Information

"Azerbaijan Railways" Closed Joint Stock Company ("ADY" or the "Company") was re-established on February 15, 2010 pursuant to the decree of the President of the Republic of Azerbaijan No. 383 "On Foundation of Azerbaijan Railways Closed Joint Stock Company" dated July 20, 2009 in connection with the development of overall railways system, meeting the increasing requirement of population and economy for transportation and freight services, improvement of management and increase of efficiency in the railways system.

The Company is 100% owned by the Cabinet of Ministers of the Republic of Azerbaijan (the "Government").

The legal address of the Company is 230, Dilara Aliyeva Street, Baku, Republic of Azerbaijan.

The Group operates a government regulated nationwide railway system providing freight transportation, railway passenger transportation, services and maintenance of railway infrastructure within the Republic of Azerbaijan.

The detailed main activities of the Group include ensuring a secure transportation of cargoes, passengers, posts as well as baggage in time by railways, formation of trains and organization of traffic on railways, provision of passenger and freight transportation services, maintenance and exploitation of unique production infrastructure, application of unique technical normative, provision of services for locomotive transportation, provision of current repair services for locomotives and trains, organization of security services on railways, protection of sites attached to railways and approval of those sites by relevant executive powers, production of necessary construction and raw materials to construct railways, construction of permanent and administrative buildings for railways, fulfillment of transportation on the basis of contracts and public orders, provision of transportation-expedition services, modernization of railways infrastructure being in use, application of telecommunication and information technologies to control services and organization of disaster-salutary services on railways.

The total length of main railways in the Republic of Azerbaijan is 2,894 km as at the reporting date; the operational length is 2,071 km, including 803 km of bilateral roads. The road consists of 192 stations. Over 22 million tons of freight is carried and over 2 million passengers are transferred annually.

Structure and projects of the Group

The Government controls the structure of the Group and establishes the long-term structure of the railway operations in the Republic of Azerbaijan. Since 2009, the Government has been in the process of restructuring the railway system in the Republic of Azerbaijan which included the establishment of the Group, the disposal of certain service businesses not related to main operations out of the Group the introduction of government investments for the improvement of the railway infrastructure.

According to the decree of the President of the Republic of Azerbaijan signed on September 18, 2015 the Group has been taken off from subordination to the Ministry of Transportation of the Republic of Azerbaijan and is directly reporting to the Cabinet of Ministers of the Republic of Azerbaijan starting from the decree date.

(In thousands of Azerbaijani Manats unless otherwise indicated)

The Government, through the Group, is continuing to restructure the railway transportation system in the Republic of Azerbaijan and has developed a mid-term development strategy for the years between 2015-2020 that includes a significant investment in the railways system. Within this strategy the Group has developed a detailed restructuring action plan, to be implemented by 2020, which will result in the establishment of robust railways infrastructure, improvement of the quality and commerciality of freight and passenger transportation services, increase of security matters in transportation, application of latest technologies in the railways system, acquisition of new locomotives, replacing direct current electrification with more efficient alternating current electrification, etc.

Pursuing the decree No. 1974 of the President of the Republic of Azerbaijan, the Government is also financing Baku-Tbilisi-Kars railway route. The funding of Baku-Tbilisi-Kars new railway line project is provided by the State Oil Fund of the Republic of Azerbaijan. The construction of this transport corridor will connect railway network of Azerbaijan, Georgia and Turkey and will serve increasing the transit potential of regional countries. Currently, the estimated date of completion of the construction is the first half of 2018.

On December 1, 2014, as part of the Azerbaijan Railways Reconstruction Project the Group entered into an agreement with Moravia Steel A.S. to supply equipment and materials, and perform related works and services for a complete refurbishment of 600 km of the rail track of the railway between Baku and Beyuk-Kyasik. The project commenced in the beginning of 2015 and is planned to be completed in 4.5 years. In order to finance this project the Group signed a loan in the amount of EUR 458,861 thousand from HSBC Bank plc on April 14, 2015.

The Government of the Republic of Azerbaijan is the party in the financing of the second phase of the Reconstruction of Railways Project and is obliged to provide EUR 74,937 thousand advance payment in two installments. The aggregate amount of these installments shall not be less than 15% of the project cost. The Government has made a payment of the first installment in the amount of EUR 39,739 thousand on November 1, 2015. This installment was provided as a loan to the Group. The details of the loan is described in Note 17.

Subsidiaries and structural changes in departments

ADY's major subsidiaries included in the consolidation as at and for the year ended December 31, 2016 are as follows:

Name of the Company	Nature of business	Group's equity interest
"Capital Construction" and "Technical Supervision" LLC	Construction management and supervision	100%
"Nakhchivan Railways" LLC	Freight and passenger transportation, construction works	100%
"Administrative Management" LLC	Administrative support	100%
"Railway Services" LLC	Construction works	100%
#11 Limited Liability Company	Construction works	100%
#5 Limited Liability Company	Construction works	100%
"Capital Repairs" LLC	Construction management and supervision	100%
"Locomotive Women Volleyball Club" LLC	Sport	100%
"Azerrail Volleyball Club" LLC	Sport	100%
"ADY Express" LLC	Logistics services	100%
Georgia branch of the Group	Construction works	100%
"AzRus Trans" CJSC	Freight transportation	51%
"Astara Grain Terminal" LLC	Logistics hub	50%

(In thousands of Azerbaijani Manats unless otherwise indicated)

ADY's major subsidiaries included in the consolidation as at and for the year ended December 31, 2015 are as follows:

Name of Company	Nature of business	Group's equity interest
"Capital Construction" and "Technical Supervision" LLC	Construction management and supervision	100%
"Nakhchivan Railways" LLC	Freight and passenger transportation, construction works	100%
"Administrative Management" LLC	Administrative support	100%
"Railway Services" LLC	Construction works	100%
#11 Limited Liability Company	Construction works	100%
#5 Limited Liability Company	Construction works	100%
"Capital Repairs" LLC	Construction management and supervision	100%
"Locomotive Women Volleyball Club" LLC	Sport	100%
"Azerrail Volleyball Club" LLC	Sport	100%
Georgia branch of the Group	Construction works	100%

During 2016, the Group made structural changes in the Infrastructure Department and Department of Maintenance and Operations to increase operational effectiveness and efficiency. New structure of the Infrastructure Department consists of 35 sub-departments.

The following table describes transfer of control of sub-departments between departments as at and for the year ended December 31, 2015:

Name of entity/department/sub-department	Previously controlled by	Control transferred to
Baku Locomotive Depo	Freight Department	Passenger Service Department
Material Resources Unit	the Group	Repair and maintenance facilities construction department
Capital Repairs LLC	the Group	Infrastructure Department
Sub-department #11	Railway Services LLC	#11 Limited Liability Company
Sub-department #74	Infrastructure Department	#11 Limited Liability Company
"Gizilja Girmadash Factory" LLC	Infrastructure Department	#11 Limited Liability Company
Sub-department #5	Railway Services LLC	#5 Limited Liability Company
Sub-department #4	Railway Services LLC	#5 Limited Liability Company

Information of subsidiaries acquired during the year ended December 31, 2016 is provided below:

Acquisition of "Karvan Logistics" LLC

On February 5, 2016, in accordance with Order #16/us/01, the Group acquired 100% of the shares of "Karvan Logistics" LLC, an unlisted company based in the Republic of Azerbaijan and specializing in the logistics services. The Group renamed the company name to "ADY Express" LLC. The share capital of "ADY Express" LLC constitutes the amount of AZN 100 comprised of 100 shares par value of AZN 1 fully owned by the Group.

The fair values of the identifiable assets and liabilities of "Karvan Logistics" LLC as at the date of acquisition were:

(In thousands of Azerbaijani Manats unless otherwise indicated)

	Fair value recognized on acquisition
Assets	
Property, plant and equipment	35
Trade and other receivables	722
Cash and cash equivalents	682
Other current assets	1,092
Total assets	**2,531**
Liabilities	
Trade and other payables	172
Advances received	1,701
Other current liabilities	5
Total liabilities	**1,878**
Total identifiable net assets at fair value	**653**
Gain on bargain purchase	653
Purchase consideration transferred	0.1

From the date of acquisition, "ADY Express" LLC contributed AZN 82,808 thousand of revenue and AZN 1,817 thousand to profit before tax from continuing operations of the Group. If the combination had taken place at the beginning of the year, revenue from continuing operations would have been AZN 90,350 thousand and profit before tax from continuing operations for the Group would have been AZN 2,432 thousand.

Establishment of "AzRusTrans" LLC

On September 6, 2016, the Company has entered into the agreement with "Rusagrotrans" LLC to establish "AzRusTrans" LLC to provide logistics services.

The initial share capital of this company is AZN 150,000 equally divided into 150,000 shares with nominal value of AZN 1 each. The shareholdings and the initial number of shares of the parties is as follows:

- "Azerbaijan Railways" CJSC owns 51% of the share capital, i.e. 76,500 shares with total nominal value of AZN 76,500;
- "Rusagrotrans" LLC owns 49% of the share capital, i.e. 73,500 shares with total nominal value of AZN 73,500.

Establishment of "Astara Grain Terminal" LLC

"Astara Grain Terminal" LLC was incorporated under the Republic of Azerbaijan law on September 23, 2016. The share capital of this company constitutes the amount of AZN 100 comprised of 100 shares with par value of AZN 1 equally owned by "ADY Express" LLC and "Yasha Inshaat" LLC. The main activity of the Company is warehousing services.

The summarized financial information of the subsidiaries acquired and established during 2016, based on amounts before inter-company eliminations is provided below:

(In thousands of Azerbaijani Manats unless otherwise indicated)

Summarized statement of financial position as at December 31, 2016:

	"ADY Express" LLC	"AzRusTrans" LLC	"Astara Grain Terminal" LLC
ASSETS			
Non-current assets:			
Property, plant and equipment	114	59	10
Total non-current assets	**114**	**59**	**10**
Current assets:			
Inventories	-	-	12
Trade and other receivables	6,673	81	-
Cash and cash equivalents	701	503	43
Other current assets	3,576	-	24
Total current assets	**10,950**	**584**	**79**
TOTAL ASSETS	**11,064**	**643**	**89**
LIABILITIES AND EQUITY			
LIABILITIES:			
Current liabilities:			
Trade and other payables	1,374	43	100
Taxes payable other than income tax	-	29	-
Income tax payable	-	20	-
Advances received	7,489	1,813	-
Other current liabilities	5	1	-
Total current liabilities	**8,868**	**1,906**	**100**
Total liabilities	**8,868**	**1,906**	**100**
EQUITY:			
Share capital	0.1	150	0.1
Retained earnings/(Accumulated loss)	2,196	(1,413)	(11)
Total equity	**2,196**	**(1,263)**	**(11)**
TOTAL LIABILITIES AND EQUITY	**11,064**	**643**	**89**

(In thousands of Azerbaijani Manats unless otherwise indicated)

Summarized statement of comprehensive income for the year ended December 31, 2016:

	"ADY Express" LLC	"AzRusTrans" LLC	"Astara Grain Terminal" LLC
Revenues			
Cargo revenues	90,350	1,313	-
Other revenues	-	162	-
Total revenues	**90,350**	**1,475**	**-**
Operating expenses			
Transportation cost	(88,154)	-	-
Depreciation and amortization	(19)	(3)	-
Wages, salaries and related contributions	(363)	(20)	(6)
Material, repairs and maintenance	(20)	(2)	-
Taxes other than income tax	(72)	(4)	(1)
Fuel expenses	(78)	-	-
Other operating costs	-	(2,951)	(4)
Total operating expenses	**(88,706)**	**(2,980)**	**(11)**
Other income			
Foreign exchange gain	843	21	-
Other income	-	91	-
Profit/(loss) before income tax	**2,487**	**(1,393)**	**(11)**
Income tax expense	(331)	(20)	-
Net profit/(loss) for the year	**2,156**	**(1,413)**	**(11)**
TOTAL COMPREHENSIVE INCOME/(LOSS) FOR THE YEAR	**2,156**	**(1,413)**	**(11)**

Acquisition of interest in "MSP International AZ" LLC

On October 1, 2016, "Railway Services" LLC, subsidiary of the Group acquired 5% interest in the voting shares of "MSP International AZ" LLC. The initial share capital of the Company is AZN 50,000 equally divided into 100 shares with nominal value of AZN 500 each.

The shareholdings and the initial number of shares of the parties is as follows:

- "Railway Services" LLC owns 5% of the share capital, i.e. 5 shares with total nominal value of AZN 2,500;
- "MSP International" s.r.o. owns 95% of the share capital, i.e. 95 shares with total nominal value of AZN 47,500.

In 2015 the Group established a new department, named "Azer Rail Volleyball Club" which is controlled by the Head Office of the Group.

(In thousands of Azerbaijani Manats unless otherwise indicated)

Common control business combination

The Ministry of Transportation of the Republic of Azerbaijan transferred ownership of the Georgian branch of "Azeravtoyol" OJSC (previously named as "Azeryolservis" OJSC) from "Azeravtoyol" OJSC to the Group through issuing order # 34/u on March 2, 2015. In accordance with this order, all assets and liabilities of the Georgia Branch of the Group (the "Branch") were combined to the balances of the Group.

The summarized financial information of the branch as at the transfer date is provided below. This information is based on the amounts reported in the branch's financial statements prepared in accordance with IFRS adjusted for the purposes of the consolidation into these consolidated financial statements before intercompany eliminations and hence it differs from the information presented in the IFRS financial statements of the branch.

	As at transfer date
Non-current assets	384
Current assets	76,903
Non-current liabilities	(7,471)
Current liabilities	(85,842)
Total net assets	**(16,026)**

Total net assets in the amount of AZN 16,026 thousand was recognized in other reserve.

Pricing policy

The pricing policy of the Group for international freight is conducted based on "Tariff policy" on International Freight adopted by CIS in Tariff Conference held annually according to Tariff Agreement dated February 17, 1993. The General Director of the Group approves the pricing policy. Prices exclude Value Added Tax ("VAT"). The tariffs are denominated in CHF. However, payments in USD and Euro are also accepted. The prices in USD and EUR are converted using average exchange rates for USD and EUR announced by Reuters till last three months the prices in CHF are announced. Prices in CHF are announced annually no later than December 1. Payments are translated to AZN using CBAR exchange rates.

Generally, the total cargo transportation price payable by a shipper of cargo consists of the following components: a charge for locomotive traction and infrastructure services and a charge for the use of a railcar. If a customer uses a railcar owned or leased by the Group, railcar component is also subject to tariff regulation.

Tariff policy is not applied for pricing of local freight. Local freight tariffs are set by the Group, reviewed annually and priced in AZN.

Liquidity

As at December 31, 2016 and 2015, the Group's current liabilities exceeded its current assets by AZN 559,258 thousand and AZN 356,971 thousand, respectively, which is to a large extent explained by the nature of the Group's current liabilities mainly represented by payables for construction, development, modernization and maintenance of property, plant and equipment as a part of Group's investment program, as well as by advances received for construction works. The Group makes significant changes in the general business terms of its contracts with credit lenders. Details are described in Note 35.

The Group is investing in expansion, modernization and maintenance of its property, plant and equipment. The Group finances its investment activities through cash generated from operations and short-term and long-term borrowings and governmental financing received in the form of grants.

The Management uses the following instruments in order to manage the Group's liquidity and overcome the negative liquidity gap in subsequent periods:

- continuous monitoring and management of credit portfolio structure aiming at extending its duration and maintaining even flows of borrowings repayment in future periods;
- maintaining diversified sources of external borrowings, including borrowings from commercial banks;
- entering into long-term and medium-term credit agreements with local banks to ensure sufficiency of available financial resources;
- using short-term bridge facilities to ensure smooth cash flows to finance investments and operations.

Management believes that through twelve months after the date of authorization of these consolidated financial statements, there will be sufficient funding from (a) existing cash balances, (b) cash generated from operations, (c) debt financing and (d) government support.

International ratings

During the year ended December 31, 2015 the Group obtained "BB-" and "BBB-"corporate ratings from "Standard and Poor's" and "Fitch" international rating agencies, respectively. Subsequently, at the beginning of 2016 the Group decided not to prolong agreements with "Fitch" and "Standard and Poor's" international rating agencies, and to terminate its corporate ratings.

2. SIGNIFICANT ACCOUNTING POLICIES

Statement of compliance

These consolidated financial statements have been prepared in accordance with IFRS issued by the International Accounting Standards Board ("IASB") and Interpretations issued by the International Financial Reporting Interpretations Committee ("IFRIC").

Principles of Consolidation

The consolidated financial statements incorporate the financial statements of the Company and entities controlled by the Company (its subsidiaries). Control is achieved where the Company has the power to govern the financial and operating policies of an investee so as to obtain benefits from its activities.

Income and expenses of subsidiaries acquired or disposed of during the year are included in the consolidated statement of comprehensive income from the effective date of acquisition and up to the effective date of disposal, as appropriate. Total comprehensive income of subsidiaries is attributed to the owners of the Group and to the non-controlling interests even if this results in the non-controlling interests having a deficit balance.

When necessary, adjustments are made to the financial statements of the branch and subsidiaries to bring their accounting policies into line with those used by other members of the Company.

All intra-group transactions, balances, income and expenses are eliminated in full on consolidation.

Business combinations and acquisition of non-controlling interests

Business combinations are accounted for using the acquisition method. The cost of an acquisition is measured as the aggregate of the consideration transferred, which is measured at acquisition date fair value, and the amount of any non-controlling interests in the acquiree. For each business combination, the Group elects whether to measure the non-controlling interests in the acquiree at fair value or at the proportionate share of the acquiree's identifiable net assets. Acquisition-related costs are expensed as incurred and included in administrative expenses.

When the Group acquires a business, it assesses the financial assets and liabilities assumed for appropriate classification and designation in accordance with the contractual terms, economic circumstances and pertinent conditions as at the acquisition date. This includes the separation of embedded derivatives in host contracts by the acquiree.

Contingent consideration, resulting from business combinations, is valued at fair value at the acquisition date as part of the business combination. Contingent consideration classified as an asset or liability that is a financial instrument and within the scope of IAS 39 "Financial Instruments: Recognition and Measurement", is measured at fair value with the changes in fair value recognized in the statement of profit or loss.

Goodwill is initially measured at cost (being the excess of the aggregate of the consideration transferred and the amount recognized for non-controlling interests and any previous interest held over the net identifiable assets acquired and liabilities assumed). If the fair value of the net assets acquired is in excess of the aggregate consideration transferred, the Group re-assesses whether it has correctly identified all of the assets acquired and all of the liabilities assumed and reviews the procedures used to measure the amounts to be recognized at the acquisition date. If the reassessment still results in an excess of the fair value of net assets acquired over the aggregate consideration transferred, then the gain is recognized in profit or loss.

Common control business combinations

IFRS 3, "Business Combinations" does not apply to a business combination of entities or businesses under common control. A business combination involving entities or businesses under common control is a business combination in which all of the combining entities or businesses are ultimately controlled by the same party or parties both before and after the business combination, and that control is not transitory. The management used "predecessor value method" for accounting of such transactions as this provides the most relevant and reliable information in accordance with IAS 8 "Accounting Policies, Changes in Accounting Estimates and Errors". A predecessor value method involves accounting for the assets and liabilities of the acquired business using existing carrying values. The difference between the acquirer's cost of investment and the acquiree's equity is presented as a separate reserve within equity on consolidation.

Going concern

These consolidated financial statements have been prepared on the assumption that the Group will be able to continue its operation on a going concern basis for the foreseeable future. Management views the Group as continuing in business for the foreseeable future with neither the intention nor the necessity of liquidation, ceasing trading or seeking protection from creditors pursuant to laws or regulations of the Republic of Azerbaijan.

Accordingly, assets and liabilities are recorded on the basis that the Group will be able to realize its assets and discharge its liabilities in the normal course of business. Some financial reporting frameworks contain an explicit requirement for management to make a specific assessment of the Group's ability to continue as a going concern, and standards regarding matters to be considered and disclosures to be made in connection with going concern.

Management's assessment of the going concern assumption involves making a judgment, at a particular point in time, about the future outcome of events or conditions which are inherently uncertain.

Other basis of presentation criteria

These consolidated financial statements are presented in thousands of Azerbaijani Manats ("AZN"), unless otherwise indicated. These consolidated financial statements have been prepared under the historical cost convention, except property, equipment and intangible assets which are stated at fair value as deemed cost.

Property, plant and equipment and intangible assets

Property, equipment and intangible assets are carried at historical cost less accumulated depreciation and amortization and any recognized impairment loss.

Depreciation on assets under construction and those not placed in service commences from the date the assets are ready for their intended use.

Depreciation and amortization are charged on the carrying value of property, equipment and intangible assets and is designed to write off assets over their useful economic lives. The estimated useful lives, residual values and depreciation/amortization method are reviewed at the end of each reporting period, with the effect of any changes in estimate accounted for on a prospective basis at the following useful lives (years):

Superstructure	13-27
Roadbed	50-75
Railway vehicles	9-12
Buildings and similar constructions	35-40
Operating equipment	8-15
Intangible assets	5-10
Other fixed assets	5-10

Expenditures related to repairs and renewals are charged when incurred and included in operating expenses unless they qualify for capitalization.

Expenditures relating to track renewals are capitalized to the extent that the flow of the future economic benefits is probable and those expenditures can be reliably measured. The replaced assets are valued at lower of cost and net realizable value and transferred to inventories or property, plant and equipment, as applicable. The excess of the carrying value of the replaced assets over their net realizable value is recognized as an expense in the consolidated statement of comprehensive income. All property that does not provide future economic benefit is expensed immediately in the consolidated statement of comprehensive income.

Intangible assets with finite useful lives that are acquired separately are carried at cost less accumulated amortization and accumulated impairment losses. Amortization is recognized on a straight-line basis over their estimated useful lives.

The estimated useful life and amortization method are reviewed at the end of each reporting period, with the effect of any changes in estimate being accounted for on a prospective basis. Intangible assets with indefinite useful lives that are acquired separately are carried at cost less accumulated impairment losses.

At the end of each reporting period, the Group reviews the carrying amounts of its property, plant and equipment and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where it is not possible to estimate the recoverable amount of an individual asset, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognized immediately in profit and loss accounts, unless the relevant asset is carried at a revalued amount, in which case the impairment loss is treated as a revaluation decrease.

Where an impairment loss subsequently reverses, the carrying amount of the asset (or a cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognized for the asset (or cash-generating unit) in prior years. A reversal of an impairment loss is recognized immediately in profit and loss accounts, unless the relevant asset is carried at a revalued amount, in which case the reversal of the impairment loss is treated as a revaluation increase.

An item of property, plant and equipment and intangible assets is derecognized upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on the disposal or retirement of an item of property and equipment is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognized in profit and loss accounts.

Prepayments

Prepayments are carried at cost less provision for impairment. A prepayment is classified as non-current when the goods or services relating to the prepayment are expected to be obtained after one year, or when the prepayment relates to an asset which will itself be classified as non-current upon initial recognition.

Prepayments to acquire assets are transferred to the carrying amount of the asset once the Group has obtained control of the asset and it is probable that future economic benefits associated with the asset will flow to the Group. Other prepayments are written off to profit and loss accounts when the goods or services relating to the prepayments are received. If there is an indication that the assets, goods or services relating to a prepayment will not be received, the carrying value of the prepayment is written down accordingly and a corresponding impairment loss is recognized in profit and loss accounts.

Inventories

Inventories are recorded at the lower of cost and net realizable value. Cost of inventory is determined on the weighted average cost basis. The cost of finished goods and work in progress includes raw materials, direct labor, other direct costs and related production overheads (based on normal operating capacity) but excludes borrowing costs. Net realizable value is the estimated selling price in the ordinary course of business, less the cost of completion and selling expenses. Inventories are reported net of provisions for damaged or obsolete items.

Financial instruments

The Group recognizes financial assets and liabilities in its consolidated statement of financial position when it becomes a party to the contractual obligations of the instrument. Regular way purchases and sales of financial assets and liabilities are recognized using settlement date accounting.

Financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities (other than financial assets and financial liabilities at fair value through profit or loss) are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at fair value through profit or loss are recognized immediately in profit and loss accounts.

Financial assets

Financial assets are classified into the following specified categories: financial assets "at fair value through profit or loss" (FVTPL), "held-to-maturity" investments, "loans and receivables" and "available-for-sale" (AFS) financial assets. The classification depends on the nature and purpose of the financial assets and is determined at the time of initial recognition.

Financial assets at FVTPL

Financial assets classified as held for trading are included in the category "financial assets at fair value through profit or loss". Financial assets are classified as held for trading if they are acquired for the purpose of selling in the near term.

Derivatives are also classified as held for trading unless they are designated and effective hedging instruments. Gains or losses on financial assets held for trading are recognized in the profit and loss accounts.

Held-to-maturity investments

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturity dates that the Group has the positive intent and ability to hold to maturity.

Held-to-maturity investments are measured at amortized cost using the effective interest method less any impairment.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are not entered into with the intention of immediate or short-term resale and are not classified as trading securities or designated as investment securities available-for-sale. Such assets are carried at amortized cost using the effective interest method.

Gains and losses are recognized in profit and loss accounts when the loans and receivables are derecognized or impaired, as well as through the amortization process.

Available-for-sale financial assets

Available-for-sale financial assets are those non-derivative financial assets that are designated as available-for-sale or are not classified in any of the three preceding categories.

After initial recognition available-for sale financial assets are measured at fair value with gains or losses being recognized in other comprehensive income until the investment is derecognized or until the investment is determined to be impaired at which time the cumulative gain or loss previously reported in other comprehensive income is reclassified to profit and loss accounts. However, interest calculated using the effective interest method is recognized in profit and loss accounts.

Loans receivable

Loans receivable are non-derivative assets with fixed or determinable payments that are not quoted in an active market, other than those classified in other categories of financial assets.

Loans receivable are initially recognized at a fair value plus related transaction costs. The difference between the fair value of consideration given and the fair value of the loans receivable is recognized as a loss on initial recognition and included in the consolidated statement of comprehensive income according to nature of these losses. Subsequently, the balances are carried at amortized cost using the effective interest method. Loans receivable are carried net of any allowance for impairment losses.

Financial guarantee contracts

Financial guarantee contracts issued by the Group are the contracts that require a payment to be made to reimburse the holder for a loss it incurs because the specific debtor fails to make a payment when due in accordance with the terms of a debt instrument. Financial guarantee contracts are initially recognized as a liability at fair value, adjusted for transaction costs that are directly attributable to the issuance of the guarantee. Subsequent to initial recognition, the Group's liability under each guarantee is measured at the higher of the best estimate of expenditure required to settle present obligation at the reporting date and the amount initially recognized less, when appropriate, cumulative amortization.

Fair value measurement

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction on the measurement date.

When available, the Group measures the fair value of an instrument using quoted prices in an active market for that instrument. A market is regarded as active if quoted prices are readily and regularly available and represent actual and regularly occurring market transactions on an arm's length basis.

If a market for a financial instrument is not active, then the Group establishes fair value using a valuation technique. The chosen valuation technique makes maximum use of market inputs, relies as little as possible on estimates specific to the Group, incorporates all factors that market participants would consider in setting a price and is consistent with accepted economic methodologies for pricing financial instruments.

Trade and other receivables

Trade and other receivables are carried at amortized cost using the effective interest method. A provision for impairment of receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of receivables. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate. The amount of the provision is recognized in the consolidated statement of comprehensive income.

The primary factors that the Group considers whether a receivable is impaired is its overdue status and realizability of related collateral, if any.

Cash and cash equivalents

Cash and cash equivalents include cash in hand, deposits held at call with banks, and other short-term highly liquid investments with original maturities of three months or less. Cash and cash equivalents are carried at amortized cost using the effective interest method. Restricted balances are excluded from cash and cash equivalents for the purposes of the cash flow statement. Balances restricted from being exchanged or used to settle a liability for at least twelve months after the reporting date are included in other non-current assets.

VAT deposit account

The Value Added Tax ("VAT") deposit account system is introduced in 2008 by the Ministry of Taxes of the Republic of Azerbaijan which aims prevention of VAT misuse. From January 1, 2008 on the basis of amendments to the Tax Code, the amount of VAT refund is considered the tax amount which is paid, according to the submitted VAT invoices to the taxpayer's VAT deposit account in the framework of transactions carried out in this account.

By the support of this module the taxpayer pays the amount of VAT indicated on the VAT invoices to the VAT deposit account of another taxpayer. At the same time tax obligations to the state budget regarding all kinds of taxes and VAT amounts on the import transactions which is necessary to be paid to the customs committee, can be paid by taxpayers through the VAT deposit account. Information about paid amounts is transferred by the Ministry of Taxes to the Main State Treasury ("MST") and then to the Central Bank of the Republic of Azerbaijan ("CBAR"). CBAR on the basis of information submitted by the Main State Treasury ensures the transformation of amounts to the relevant local treasury authorities. The Ministry of Taxes ensures inclusion of amounts which is noted in the submitted information to the taxpayer's personal files. The current system is connected with the Automated Tax Information System of the Ministry of Taxes. At the same time online exchange of information was organized with the MST and CBAR.

Implementation of the VAT deposit account makes it possible to timely control payments and refunded VAT amounts. Taxpayers who have tax debts can only transfer these amounts to the state budget. Taxpayers can make payments to the state budget without visiting banks, to the sub-accounts of other taxpayers and to the customs committee through the deposit account. The Ministry of Taxes automatically controls all transactions carried out through the deposit account using special software.

Use of balances in the VAT deposit account is restricted and can be used only for transactions connected with VAT and other applicable taxes.

Reclassification of financial assets

If a non-derivative financial asset classified as held for trading is no longer held for the purpose of selling in the near term, it may be reclassified out of the fair value through profit or loss category in one of the following cases:

- A financial asset that would have met the definition of loans and receivables above may be reclassified to loans and receivables category if the Group has the intention and ability to hold it for the foreseeable future or until maturity;
- Other financial assets may be reclassified to available for sale or held-to-maturity categories only in rare circumstances.

A financial asset classified as available-for-sale that would have met the definition of loans and receivables may be reclassified to loans and receivables category of the Group has the intention and ability to hold it for the foreseeable future or until maturity.

Financial assets are reclassified at their fair value on the date of reclassification. Any gain or loss already recognized in profit and loss accounts is not reversed. The fair value of the financial asset on the date of reclassification becomes its new cost or amortized cost, as applicable.

Impairment of financial assets

The Group assesses at each reporting date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred "loss event") and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. Evidence of impairment may include indications that the borrower or a group of borrowers is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganization and where observable data indicate that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

De-recognition of financial assets

The Group derecognizes a financial asset only when the contractual rights to the cash flows from the asset expire, or when it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity. If the Group neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, the Group recognizes its retained interest in the asset and an associated liability for amounts it may have to pay. If the Group retains substantially all the risks and rewards of ownership of a transferred financial asset, the Group continues to recognize the financial asset and also recognizes a collateralized borrowing for the proceeds received.

On de-recognition of a financial asset in its entirety, the difference between the asset's carrying amount and the sum of the consideration received and receivable and the cumulative gain or loss that had been recognized in other comprehensive income and accumulated in equity is recognized in profit and loss accounts.

On de-recognition of a financial asset other than in its entirety (for example, when the Group retains an option to repurchase part of the transferred asset or retains a residual interest that does not result in the retention of substantially all the risks and rewards of ownership and the Group retains control), the Group allocates the previous carrying amount of the financial asset between the part it continues to recognize under continuing involvement, and the part it no longer recognizes on the basis of the relative fair values of those parts on the date of the transfer.

The difference between the carrying amount allocated to the part that is no longer recognized and the sum of the consideration received for the part no longer recognized and any cumulative gain or loss allocated to it that had been recognized in other comprehensive income is recognized in profit and loss accounts. A cumulative gain or loss that had been recognized in other comprehensive income is allocated between the part that continues to be recognized and the part that is no longer recognized on the basis of the relative fair values of those parts.

Financial liabilities

Financial liabilities are classified as either "financial liabilities at FVTPL" or "other financial liabilities".

Financial liabilities at FVTPL

Financial liabilities are classified as FVTPL when the financial liability is either held for trading or it is designated as at FVTPL.

Financial liabilities at FVTPL are stated at fair value, with any gains or losses arising on re-measurement recognized in profit and loss accounts. The net gain or loss recognized in profit and loss accounts incorporates any interest paid on the financial liability and is included in the "other income, net" line item in the consolidated statement of comprehensive income.

Other financial liabilities

Other financial liabilities are initially measured at fair value, net of transaction costs.

Other financial liabilities are subsequently measured at amortized cost using the effective interest method, with interest expense recognized on an effective yield basis.

The effective interest method is a method of calculating the amortized cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments through the expected life of the financial liability, or (where appropriate) a shorter period, to the net carrying amount on initial recognition.

Borrowings

Borrowings are carried at amortized cost using the effective interest method.

Borrowing costs directly attributable to the acquisition, construction or production of an asset that necessarily takes a substantial period of time to get ready for its intended use or sale are capitalized as part of the cost of the asset. All other borrowing costs are expensed in the period in which they occur.

Borrowing costs consist of interest and other costs that an entity incurs in connection with the borrowing of funds.

Leases

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

Finance leases

Assets held under finance leases are initially recognized as assets of the Group at their fair value at the inception of the lease or, if lower, at the present value of the minimum lease payments. The corresponding liability to the lessor is included in the consolidated statement of financial position as a finance lease obligation.

Lease payments are apportioned between finance expenses and reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability. Finance expenses are recognized immediately in profit or loss unless they are directly attributable to qualifying assets, in which case they are capitalized in accordance with the Group's general policy on borrowing costs. Contingent rentals are recognized as expenses in the periods in which they are incurred.

Operating leases

Where the Group is a lessee in a lease which does not transfer substantially all the risks and rewards incidental to ownership from the lessor to the Group, the total lease payments are charged to profit and loss accounts on a straight-line basis over the lease term.

The lease term is the non-cancellable period for which the lessee has contracted to lease the asset together with any further terms for which the lessee has the option to continue to lease the asset, with or without further payment, when at the inception of the lease it is reasonably certain that the lessee will exercise the option.

Where the Group is a lessor, rental income from operating lease is recognized on a straight line basis over the term of relevant lease. Initial direct costs in negotiating and arranging an operating lease are added to the carrying amount of the leased asset and recognized over the lease term.

Trade and other payables

Trade payables are accrued when the counterparty performed its obligations under the contract and are carried at amortized cost using the effective interest method.

Advances received

Advances received from customers refers to an item that will initially be recorded as a liability, but is expected to become an asset over time and/or through the normal operations of the business. Advances received from customers are initially recorded at the fair value of consideration received plus any directly attributable transaction costs, and subsequently are carried at amortized cost.

De-recognition of financial liabilities

The Group derecognizes financial liabilities when, and only when, the Group's obligations are discharged, cancelled or they expire. The difference between the carrying amount of the financial liability derecognized and the consideration paid and payable is recognized in profit and loss accounts.

Offset of financial assets and liabilities

Financial assets and liabilities are offset and reported net on the consolidated statement of financial position when the Group has a legally enforceable right to set off the recognized amounts and the Group intends either to settle on a net basis or to realize the asset and settle the liability simultaneously. In accounting for a transfer of a financial asset that does not qualify for de-recognition, the Group does not offset the transferred asset and the associated liability.

Provisions

Provisions are recognized when the Group has a present legal or constructive obligation as a result of past events, and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate of the obligation can be made.

The amount recognized as a provision is the best estimate of the consideration required to settle the present obligation at the end of the reporting period, taking into account the risks and uncertainties surrounding the obligation.

When a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows (where the effect of the time value of money is material).

When some or all of the economic benefits required to settle a provision are expected to be recovered from a third party, a receivable is recognized as an asset if it is virtually certain that reimbursement will be received and the amount of the receivable can be measured reliably.

Taxation

Income tax

Income tax expense represents the sum of the tax currently payable and deferred tax expense. The tax currently payable is based on taxable profit for the year. Taxable profit differs from net profit as reported in the consolidated statement of comprehensive income because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Group's current tax expense is calculated using tax rates that have been enacted or substantively enacted by the end of the reporting period.

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the consolidated financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognized for all taxable temporary differences and deferred tax assets are recognized to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilized. Such assets and liabilities are not recognized if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the tax profit nor the accounting profit.

The carrying amount of deferred tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realized. Deferred tax is charged or credited in the consolidated statement of comprehensive income, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

Deferred income tax assets and deferred income tax liabilities are offset and reported net on the consolidated statement of financial position if:

- The Group has a legally enforceable right to set off current income tax assets against current income tax liabilities; and

- Deferred income tax assets and the deferred income tax liability relate to income taxes levied by the same taxation authority on the same taxable entity.

Value added tax

The difference of output VAT and claimable input VAT is payable to the state budget within 20 days following the reporting month. Output value added tax related to sales is payable to tax authorities on the earlier of (a) collection of the receivables from customers or (b) delivery of the goods or services to customers. Input VAT is generally recoverable against output VAT upon receipt of the VAT invoice. The tax authorities permit the settlement of VAT on a net basis.

VAT related to sales and purchases is recognized in the statement of financial position on a gross basis and disclosed separately as an asset and liability. Where provision has been made for impairment of receivables, impairment loss is recorded for the gross amount of the debtor, including VAT.

Land tax

Owners and users of land in the Republic of Azerbaijan are subject to land tax at varying rates. The rate of tax varying from AZN 0.06 up to AZN 20 depends on the type of land, i.e. agricultural, industrial, construction, communication, trading or residential land, as well as the location of land.

The reporting period is a calendar year. For legal entities owning or using the land the deadline for tax filing is May 15 of each year, while the tax should be paid in equal installments no later than August 15 and November 15.

Property tax

Except for cases when the property has been insured at a value exceeding its residual value and the property tax is then calculated on the market value, the taxable base for resident legal entities and non-resident legal entities with permanent establishment is the average annual residual value of their fixed assets. Thus, an average annual residual value of fixed assets owned by such legal entities is subject to a property tax at the rate of 1%. At the same time, the taxable base in respect of resident and non-resident individuals comprises of buildings and their parts, as well as resident individuals' water and air transportation means, where the property tax rate varies depending on the type of asset owned.

The reporting period is a calendar year. Legal entities, owning the fixed assets, have to file the tax return no later than March 31 of the year following the reporting period. The property taxpayer legal entities remit the tax by way of advances (20% of the last year's property tax) by the 15th of the second month of each quarter with the final balancing payment due no later than the filing deadline mentioned above.

The Republic of Azerbaijan also has various other taxes, which are assessed on the Group's activities. These taxes are included in the consolidated statement of comprehensive income.

Share capital

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of ordinary shares are recognized as a deduction from equity, net of any tax effects. Dividends on ordinary shares are recognized in equity as a reduction in the period in which they are declared.

Dividends that are declared after the reporting date are treated as a subsequent event under International Accounting Standard 10 "Events after the Reporting Date" ("IAS 10") and disclosed accordingly.

Government investments

According to the decree No. 183 of the Cabinet of the Ministers of the Republic of Azerbaijan dated October 22, 2010, all government investments allocated to the state companies of the Republic of Azerbaijan for the purposes of improvement of the infrastructure and enhancement of their operations since 2007 should be included in the share capital of these entities.

The Group policy is that government investments are initially recorded in government investments line in the equity until they are registered in relevant government agencies. It is then classified as share capital when all necessary documentary works are completed and amounts are registered in relevant government agency.

Other reserve

Other reserve represents the difference between the acquirer's cost of investment and the acquiree's equity under common control business combinations.

Revenue and expense recognition

Revenues are recognized when it is probable that the economic benefits associated with the transaction will flow to the Group and the amount of revenues can be measured reliably.

Revenues and expenses are accounted for at the time the actual flow of related goods and services occurs and transfer of risks and rewards has been completed, regardless of when cash or its equivalent is received or paid, and are reported in the statement of comprehensive income in the period to which they relate. The Group assesses its revenue arrangements against specific criteria in order to determine if it is acting as a principal or an agent.

Transportation services

In respect of services related to cargo transportation, revenue is recognized by reference to the stage of completion of the transportation at the reporting date provided that the stage of completion of the transportation or other specific condition has been met and the amount of revenue can be measured reliably. In the event that either of the conditions above is not met as at the reporting date, the recognition of revenue is deferred to the date when transportation is completed, i.e. cargo delivered to the place of destination. The stage of completion is determined as a percentage of services performed to date to total services to be performed.

In respect of services related to passenger transportation, revenue is recognized when transportation is completed.

Revenue from construction services

The Group renders significant construction services to third parties under long-term construction contracts.

Revenue from construction services rendered is recognized in the consolidated statement of comprehensive income on a monthly basis in accordance with the actual volume of works completed. The stage of completion is assessed monthly.

When the outcome of the contract cannot be estimated reliably, contract revenue is recognized only to the extent of contract costs incurred that are likely to be recoverable. The Group provides for estimated losses on uncompleted contracts in the period, in which such losses are identified.

Interest income and expenses

Interest income and expenses are recorded using the effective interest rate, which is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to the net carrying amount of such an instrument, taking into consideration all contractual terms of the instrument.

Employee benefits

Wages, salaries, contributions to the Republic of Azerbaijan state pension and social insurance funds, paid annual leave and sick leave, bonuses, and non-monetary benefits (such as health services and child care services) are accrued in the year in which the associated services are rendered by the employees of the Group.

(In thousands of Azerbaijani Manats unless otherwise indicated)

Foreign currency translation

The functional currency of the Group is the currency of the primary economic environment, in which it operates. The Group's functional currency is AZN.

Financial assets and liabilities denominated in foreign currencies are translated into AZN at the appropriate spot rates of exchange of the CBAR ruling at the end of reporting date. Foreign currency transactions are accounted for at the exchange rates prevailing at the date of the transaction.

On February 21, 2015 the Central Bank of the Republic of Azerbaijan ("CBAR") devalued the Azerbaijani Manat (AZN). As a result, the official exchange rates of AZN to the US dollar fell to AZN 1.05 the US dollar, and the official exchange rate of AZN to the Euro fell to AZN 1.19 per Euro, i.e. by approximately 34% from the exchange rates at the effective date of devaluation.

On December 21, 2015 the CBAR introduced a floating exchange rate that resulted in one-time devaluation of the Azerbaijani Manat ("AZN") against the US dollar and other major currencies by approximately 48%.

The devaluation of Azerbaijani Manat continued in 2016 and resulted in 14% fall against the US dollars and 9% fall against Euro by December 31, 2016.

Profits and losses arising from these translations are included in foreign exchange translation gain/(loss) account.

The exchange rates at reporting date used by the Group in the preparation of the consolidated financial statements are as follows:

	December 31, 2016	December 31, 2015
USD/AZN	1.7707	1.5594
EUR/AZN	1.8644	1.7046
GEL/AZN	0.6663	0.6511
CHF/AZN	1.7351	1.5709
RUR/AZN	0.0293	0.0216
KZT/AZN	0.0053	0.0046

Foreign currency translational reserve

On consolidation, the assets and liabilities of foreign operations are translated into AZN at the rate of exchange prevailing at the reporting date and their statements of comprehensive income are translated at exchange rates prevailing at the dates of the transactions. The exchange differences arising on translation for consolidation purposes are recognized in other comprehensive income. On disposal of a foreign operation, the component of the other comprehensive income relating to that particular foreign operation is recognized in profit and loss accounts.

Contingent liabilities and assets

Contingent liabilities are not recognized in the consolidated financial statements. They are disclosed in the notes to the financial statements unless the possibility of an outflow of resources embodying economic benefits is remote.

Contingent assets are not recognized in the consolidated financial statements but disclosed when an inflow of economic benefits is probable.

3. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES

The preparation of consolidated financial statements requires management to make judgments, estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, costs and disclosure of contingent liabilities during the reporting period.

As a result of the uncertainties inherent in business activities, many items in financial statements cannot be measured with precision but can only be estimated. Estimation involves judgments based on the latest information available when the consolidated financial statements were prepared. Existing circumstances and assumptions about future developments, however, may change due to market changes or circumstances arising beyond the control of the Group. Such changes are reflected in the assumptions when they occur.

The most significant estimates relate to the depreciable lives of property, plant and equipment, impairment of non-financial and financial assets, fair value of financial instruments, provision for obsolete inventory, provision for tax and legal contingencies and deferred taxation. Actual results could differ from these estimates.

Useful life of property, plant and equipment

The Group assesses the remaining useful lives of items of property, plant and equipment at least at each financial year-end. If expectations differ from previous estimates, the changes are accounted for as a change in an accounting estimate in accordance with IAS 8 "Accounting Policies, Changes in Accounting Estimates and Errors". These estimates may have a material impact on the amount of the carrying values of property, plant and equipment and on depreciation recognized in profit and loss accounts.

Impairment of property, plant and equipment and other non-financial assets

The Group assesses at each reporting date whether there is any indication that an asset or any of the Groups' cash-generating units ("CGU"s) may be impaired and determines recoverable amount of an asset or a CGU if impairment indicators are identified. Recoverable amount is the higher of an asset's or CGUs fair value less costs of disposal and its value in use. When the carrying amount of an asset or a CGU exceeds its recoverable amount, the asset or CGU is considered impaired and is written down to its recoverable amount.

In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessment of the time value of money and the risks specific to the asset. In determining fair value less costs to sell, recent market transactions are taken into account, if available. If no such transactions can be identified, an appropriate valuation model is used.

The Group bases its value in use calculation on detailed budgets and forecast calculations which are prepared separately for each of the Group's CGU to which the individual asset is allocated. These budgets estimates and forecasts generally cover the period of 5 years. For longer periods, a long-term growth rate is determined and applied to projected future cash flows after the tenth year.

Due to significant uncertainties regarding future changes in the tariff-setting policy management cannot predict what effect changes in fiscal and political policies may have on the Group's remaining investment or ability to make future investments in property, plant and equipment, which may affect the recoverable amount of such investments. Management plans to revisit such an assessment at the time more certainty regarding factors outlined above exist and upon finalization of Group's property, plant and equipment registers for the movements in property, plant and equipment, including the effects of impairment and accounting for components, in accordance with its accounting policy. Accordingly, the amount of impairment loss may be revised.

The value of the CGUs was calculated by discounting the future cash flows at the rate of 6.5% on pre-tax base and impairment charge of AZN 229,386 thousand (2015: AZN 205,455 thousand) has been recognized in consolidated statement of comprehensive income to write-down the book value of certain property, plant and equipment with regard to the functional use of these assets. The discount rate calculation is based on the specific circumstances of the Group and its operating segments and derived from its weighted average cost of capital ("WACC"). In calculating WACC the cost of equity was estimated using peer group data and the cost of debt is based on interest bearing borrowings, the Group is obliged to service. Specific risks are incorporated by applying individual beta factors, market risk and size of the Group. The beta factors are evaluated annually based on publicly available market data. If the estimated WACC used in the calculation had been 1% higher than management's estimate, the aggregate amount of impairment loss would have been AZN 633,314 thousand higher (2015: AZN 648,515 thousand higher). 6.23% is the threshold level where there is no need for impairment (2015: 8.08%).

These estimates, including the methodologies used, may have a material impact on the amount of any property, plant and equipment and other non-financial assets impairment.

As at December 31, 2016 and 2015 the Group has provided allowance against prepayment for inventories and services made in the amount of AZN 30,840 thousand and AZN 24,525 thousand, correspondingly.

Inventory valuation

Inventory is valued at the lower of cost or net realizable value. The Group records an allowance to reduce the carrying value of obsolete and slow-moving inventory to net realizable value, when appropriate. The actual value realized on disposition of such inventory may differ from the net realizable value; any such difference could have a significant impact on future operating results.

As at December 31, 2016 and 2015 the Group has provided allowance for loss on damaged and obsolete inventory in the amount of AZN 12,500 thousand and AZN 33,777 thousand, correspondingly.

Recoverability of VAT

At each reporting date the Group assesses the recoverability of VAT arising on purchase of goods and services. The Group can only receive these amounts through an offset against future VAT liability or collection from the tax authorities. In assessing the recoverability of the VAT receivable, the Group considers information from the internal tax department regarding projected VAT liability, correspondence with government tax authorities, and historical recovery experience. The actual amount of VAT recovery could differ materially from the Groups estimate and this could materially impact operating results.

Impairment of financial assets

The Group assesses, at each reporting date, whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred 'loss event') and that loss event has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. Evidence of impairment may include indications that the debtors or a group of debtors is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganization and when observable data indicate that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

As at December 31, 2016 and 2015 the Group has provided allowance for impairment losses in the amount of AZN 114,210 thousand and AZN 85,079 thousand for loans receivable and allowance for bad debt in the amount of AZN 90,868 thousand and AZN 41,344 thousand for trade and other receivables, respectively.

Litigations

The Group exercises considerable judgment in measuring and recognizing provisions and the exposure to contingent liabilities related to pending litigations or other outstanding claims subject to negotiated settlement, mediation, arbitration or government regulation, as well as other contingent liabilities. Judgment is necessary in assessing the likelihood that a pending claim will succeed, or a liability will arise, and to quantify the possible range of the final settlement. Because of the inherent uncertainties in this evaluation process, actual losses may be different from the originally estimated provision. These estimates are subject to change as new information becomes available, primarily with the support of internal specialists, if available, or with the support of outside consultants, such as legal counsel. Revisions to the estimates may significantly affect future operating results.

Current taxes

Azerbaijani tax, currency and customs legislation is subject to varying interpretations and changes occur frequently. Further, the interpretation of tax legislation by tax authorities as applied to the transactions and activity of the Group's entities may not coincide with that of management. As a result, tax authorities may challenge transactions and the Group's entities may be assessed additional taxes, penalties and interest, which can be significant.

Periods remain open to review by the tax and customs authorities with respect to tax liabilities for three calendar years preceding the year of review. Under certain circumstances reviews may cover longer periods. As at December 31, 2016, the management believes that its interpretation of the relevant legislation is appropriate and that it is probable that the Group's tax, currency and customs positions will be sustained.

Fair value of financial instruments

Where the fair value of financial assets and financial liabilities recorded in the statement of financial position cannot be derived from active markets, they are determined using valuation techniques including the discounted cash flows model. The inputs to these models are taken from observable markets where possible, but where this is not feasible, a degree of judgment is required in establishing fair values. The judgments include considerations of inputs such as liquidity risk, credit risk and volatility. Changes in assumptions about these factors could affect the reported fair value of financial instruments.

Construction contract

When the outcome of a construction contract cannot be estimated reliably revenue is recognized only to the extent of contract costs incurred that it is probable will be recoverable; and contract costs are recognized as an expense in the period in which they are incurred. An expected loss on the construction contract is recognized as an expense immediately. The expected loss is assessed based on analysis performed by the management of the Group in accordance with approved project budget.

4. ADOPTION OF NEW OR REVISED STANDARDS AND INTERPRETATIONS

In the current year, the Group has adopted all of the applicable new and revised Standards and Interpretations issued by the IASB and the IFRIC of the IASB that are relevant to its operations and effective for annual reporting periods ending in December 31, 2016. The adoption of these new and revised Standards and Interpretations has not resulted in significant changes to the Group's accounting policies that have affected the amounts reported for the current or prior years.

Amendments to IAS 1 "Presentation of Financial Statements": Disclosure Initiative – The amendments to IAS 1 "Presentation of Financial Statements" clarify, rather than significantly change, existing IAS 1 requirements.

The amendments clarify:

- The materiality requirements in IAS 1;
- That specific line items in the statement(s) of profit or loss and other comprehensive income and the statement of financial position may be disaggregated;
- Those entities have flexibility as to the order in which they present the notes to financial statements; and
- That the share of Other Comprehensive Income ("OCI") of associates and joint ventures accounted for using the equity method must be presented in aggregate as a single line item, and classified between those items that will or will not be subsequently reclassified to profit or loss.

Furthermore, the amendments clarify the requirements that apply when additional subtotals are presented in the statement of financial position and the statement(s) of profit or loss and other comprehensive income.

Amendments to IAS 16 and IAS 38 "Clarification of Acceptable Methods of Depreciation and Amortization" – The amendments to IAS 16 prohibit entities from using a revenue-based depreciation method for items of property and equipment. The amendments to IAS 38 introduce a rebuttable presumption that revenue is not an appropriate basis for amortization of intangible assets. This presumption can only be rebutted in the following two limited circumstances:

a) When the intangible asset is expressed as a measure of revenue; or
b) When it can be demonstrated that revenue and the consumption of the economic benefits of the intangible asset are highly correlated.

Amendments to IAS 16 and IAS 41 "Agriculture": Bearer Plants – The amendments to IAS 16 "Property and equipment" and IAS 41 "Agriculture" define a bearer plant and require biological assets that meet the definition of a bearer plant to be accounted for as property and equipment in accordance with IAS 16, instead of IAS 41. In terms of the amendments, bearer plants can be measured using either the cost model or the revaluation model set out in IAS 16.

On the initial application of the amendments, entities are permitted to use the fair value of items of bearer plant as their deemed cost as at beginning of the earliest period presented. Any difference between the previous carrying amount and fair value should be recognized in opening retained earnings at the beginning of the earliest period presented.

The produce growing on bearer plants continues to be accounted for in accordance with IAS 41.

Amendments to IAS 27 "Equity Method in Separate Financial Statements" – The amendments to IAS 27 "Separate Financial Statements" allow an entity to use the equity method as described in IAS 28 to account for its investments in subsidiaries, joint ventures and associates in its separate financial statements. Therefore, an entity must account for these investments either:

- At cost;
- In accordance with IFRS 9 (or IAS 39); or
- Using the equity method.

The entity must apply the same accounting for each category of investments. A consequential amendment was also made to IFRS 1 "First-time Adoption of International Financial Reporting Standards". The amendment to IFRS 1 allows a first-time adopter accounting for investments in the separate financial statements using the equity method, to apply the IFRS 1 exemption for past business combinations to the acquisition of the investment.

Amendments to IFRS 10, IFRS 12 and IAS 28 "Investment Entities: Applying the Consolidation Exception" – The amendments address issues that have arisen in applying the investment entities exception under IFRS 10.

The amendments to IFRS 10 clarify that the exemption (in IFRS 10.4) from presenting consolidated financial statements applies to a parent entity that is a subsidiary of an investment entity, when the investment entity measures all of its subsidiaries at fair value.

Furthermore, the amendments to IFRS 10 clarify that only a subsidiary of an investment entity that is not an investment entity itself and that provides support services to the investment entity is consolidated. All other subsidiaries of an investment entity are measured at fair value.

The amendments to IAS 28 allow the investor, when applying the equity method, to retain the fair value measurement applied by the investment entity associate or joint venture to its interests in subsidiaries.

Amendments to IFRS 10 and IAS 28 "Sale or Contribution of Assets between an Investor and its Associate or Joint Venture" – The amendments address the conflict between IFRS 10 and IAS 28 in dealing with the loss of control of a subsidiary that is sold or contributed to an associate or joint venture.

The amendments clarify that the gain or loss resulting from the sale or contribution of assets that constitute a business, as defined in IFRS 3 "Business Combinations", between an investor and its associate or joint venture, is recognised in full. Any gain or loss resulting from the sale or contribution of assets that do not constitute a business, however, is recognised only to the extent of unrelated investors' interests in the associate or joint venture.

Amendments to IFRS 11 "Accounting for Acquisitions of Interests in Joint Operations" – The amendments to IFRS 11 provide guidance on how to account for the acquisition of an interest in a joint operation in which the activities constitute a business as defined in IFRS 3 "Business Combinations". Specifically, the amendments state that the relevant principles on accounting for business combinations in IFRS 3 and other standards (e.g. IAS 36 "Impairment of Assets" regarding impairment testing of a cash-generating unit to which goodwill on acquisition of a joint operation has been allocated) should be applied. The same requirements should be applied to the formation of a joint operation if and only if an existing business is contributed to the joint operation by one of the parties that participate in the joint operation.

A joint operator is also required to disclose the relevant information required by IFRS 3 and other standards for business combinations.

IFRS 14 "Regulatory Deferral Accounts" allows rate-regulated entities to continue recognizing regulatory deferral accounts in connection with their first-time adoption of IFRS. Existing IFRS preparers are prohibited from adopting this standard. Entities that adopt IFRS 14 must present the regulatory deferral accounts as separate line items on the statement of financial position and present movements in these account balances as separate line items in the statement of profit or loss and other comprehensive income. The standard requires disclosures on the nature of, and risks associated with, the entity's rate regulation and the effects of that rate regulation on its financial statements.

Annual improvements to IFRSs 2012-2014 Cycle – The Annual Improvements include amendments to a number of IFRSs, which have been summarized below.

(In thousands of Azerbaijani Manats unless otherwise indicated)

Standard	Subject of amendment
IFRS 5 "Non-Current Assets Held for Sale and Discontinued Operations"	Changes in methods of disposal
IFRS 7 "Financial Instruments: Disclosures"	Servicing contracts and applicability of the offsetting disclosures to condensed interim financial statements
IAS 19 "Employee Benefits"	Discount rate: regional market issue
IAS 34 "Interim Financial Reporting"	Disclosure of information "elsewhere in the interim financial report"

Unless otherwise described above, the new Standards and Interpretations are not expected to significantly affect the Group's financial statements.

5. STANDARDS AND INTERPRETATIONS ISSUED AND NOT YET ADOPTED

At the date of authorization of these consolidated financial statements, other than the Standards and Interpretations adopted by the Group in advance of their effective dates, the following Interpretations were in issue but not yet effective.

Amendments to IAS 7 "Statement of Cash Flows" – The amendments are intended to clarify IAS 7 to improve information provided to users of financial statements about an entity's financing activities.

To achieve this objective, the IASB requires that the following changes in liabilities arising from financing activities are disclosed (to the extent necessary): (i) changes from financing cash flows; (ii) changes arising from obtaining or losing control of subsidiaries or other businesses; (iii) the effect of changes in foreign exchange rates; (iv) changes in fair values; and (v) other changes.

The amendments are effective for annual periods beginning on or after January 1, 2017, with earlier application being permitted.

Amendments to IAS 12 "Income Taxes" – The amendments to IAS 12 "Income Taxes" clarify how to account for deferred tax assets related to debt instruments measured at fair value and clarify recognition of deferred tax assets for unrealized losses, to address diversity in practice.

Entities are required to apply the amendments for annual periods beginning on or after January 1, 2017. Earlier application is permitted.

Annual Improvements to IFRS Standards 2014-2016 Cycle contains amendments to three International Financial Reporting Standards (IFRSs) as result of the IASB's annual improvements project.

Standard	Subject of amendment
IFRS 1 "First-time Adoption of International Financial Reporting Standards"	Deletion of short-term exemptions for the first-time adopters: The amendments delete the short-term exemptions in IFRS 1 that relate to IFRS 7, IAS 19, IFRS 12 and IAS 27.
IFRS 12 "Disclosure of Interests in Other Entities"	Clarification of the scope of the Standard: IFRS 12 states that an entity need not provide summarized financial information for interests in subsidiaries, associates or joint ventures that are classified as held for sale. The amendment clarifies that this is the only concession from disclosure requirements of IFRS 12 for such interests.

(In thousands of Azerbaijani Manats unless otherwise indicated)

IAS 28 "Investments in Associates and Joint Ventures"	Measuring an associate or joint venture at fair value: The amendments clarify that the election to measure at fair value through profit or loss an investment in an associate or a joint venture that is held by an entity that is a venture capital organization, or other qualifying entity, is available for each investment in an associate or joint venture on an investment-by-investment basis, upon initial recognition.

The amendments to IFRS 1 and IAS 28 are effective for annual periods begin on or after January 1 2018, the amendment to IFRS 12 for annual periods beginning on or after January 1, 2017.

The IASB and FASB have issued their joint revenue recognition standard, IFRS 15 "Revenue from Contracts with Customers", which replaces all existing IFRS and US GAAP revenue requirements. IFRS 15 specifies how and when an IFRS reporter will recognize revenue as well as requiring such entities to provide users of financial statements with more informative, relevant disclosures. The standard provides a single, principles based five-step model to be applied to all contracts with customers. IFRS 15 was issued in May 2014 and applies to an annual reporting period beginning on or after January 1, 2018. An earlier application is permitted.

Amendments to IAS 40 "Transfers of Investment Property" are intended to clarify that an entity can only reclassify a property to/from investment property when, and only when, there is evidence that a change in the use of the property occurred. The amendments are effective for periods beginning on or after January 1, 2018. Earlier application is permitted. An entity applies the amendments to changes in use that occur on or after the beginning of the annual reporting period in which the entity first applies the amendments. Retrospective application is also permitted if that is possible without the use of hindsight.

IFRIC 22 "Foreign Currency Transactions and Advance Consideration" addresses foreign currency transactions or parts of transactions where:

- there is consideration that is denominated or priced in a foreign currency;
- the entity recognizes a prepayment asset or a deferred income liability in respect of that consideration, in advance of the recognition of the related asset, expense or income; and
- the prepayment asset or deferred income liability is non-monetary.

The Interpretations Committee came to the following conclusion that the date of the transaction, for the purpose of determining the exchange rate, is the date of initial recognition of the non-monetary prepayment asset or deferred income liability. If there are multiple payments or receipts in advance, a date of transaction is established for each payment or receipt. The interpretation applies to annual reporting periods beginning or after January 1, 2018. An earlier adoption is permitted.

IFRS 9 "Financial Instruments" issued in November 2009 and amended in October 2010 introduces new requirements for the classification and measurement of financial assets and financial liabilities and for de-recognition.

- IFRS 9 requires all recognized financial assets that are within the scope of IAS 39 "Financial Instruments: Recognition and Measurement" to be subsequently measured at amortized cost or fair value. Specifically, debt investments that are held within a business model whose objective is to collect the contractual cash flows, and that have contractual cash flows that are solely payments of principal and interest on the principal outstanding are generally measured at amortized cost at the end of subsequent accounting periods. All other debt investments and equity investments are measured at their fair values at the end of subsequent accounting periods;

- The most significant effect of IFRS 9 regarding the classification and measurement of financial liabilities relates to the accounting for changes in fair value of a financial liability (designated as at fair value through profit or loss) attributable to changes in the credit risk of that liability. Specifically, under IFRS 9, for financial liabilities that are designated as at fair value through profit or loss, the amount of change in the fair value of the financial liability that is attributable to changes in the credit risk of that liability is recognized in other comprehensive income, unless the recognition of the effects of changes in the liability's credit risk in other comprehensive income would create or enlarge an accounting mismatch in profit and loss accounts. Changes in fair value attributable to a financial liability's credit risk are not subsequently reclassified to profit and loss accounts. Previously, under IAS 39, the entire amount of the change in the fair value of the financial liability designated as at fair value through profit and loss accounts was recognized in profit and loss accounts.

IFRS 9 is effective for annual periods beginning on or after January 1, 2018.

Amendments to IFRS 2 "Share-Based Payment" – The IASB have published final amendments to IFRS 2 "Share-based Payment" that clarify the classification and measurement of share-based payment transactions. Classification and Measurement of Share-based Payment Transactions contains the following clarifications and amendments:

Accounting for cash-settled share-based payment transactions that include a performance condition

Until issue of these amendments, IFRS 2 contained no guidance on how vesting conditions affect the fair value of liabilities for cash-settled share-based payments. IASB has now added guidance that introduces accounting requirements for cash-settled share-based payments that follows the same approach as used for equity-settled share-based payments.

Classification of share-based payment transactions with net settlement features

The IASB has introduced an exception into IFRS 2 so that a share-based payment where the entity settles the share-based payment arrangement net is classified as equity-settled in its entirety provided the share-based payment would have been classified as equity-settled had it not included the net settlement feature.

Accounting for modifications of share-based payment transactions from cash-settled to equity-settled

Until issue of these amendments, IFRS 2 did not specifically address situations where a cash-settled share-based payment changes to an equity-settled share-based payment because of modifications of the terms and conditions. The IASB has introduced the following clarifications:

- On such modifications, the original liability recognized in respect of the cash-settled share-based payment is derecognized and the equity-settled share-based payment is recognized at the modification date fair value to the extent services have been rendered up to the modification date;
- Any difference between the carrying amount of the liability as at the modification date and the amount recognized in equity at the same date would be recognized in profit and loss immediately.

The amendments are effective for annual periods beginning on or after January 1, 2018. Earlier application is permitted.

IFRS 16 "Leases", which specifies how and IFRS reporter will recognize, measure, present and disclose leases. The standard provides a single lessee accounting model, requiring lessees to recognize assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset has a low value. Lessors continue to classify leases as operating or finance, with IFRS 16's approach to lessor accounting substantially unchanged from its predecessor, IAS 17.

IFRS 16 was issued on January 13, 2016 and applies to an annual reporting period beginning on or after January 1, 2019.

IFRS 17 "Insurance contracts" was issued in May 2017 and replaced IFRS 4 "Insurance contracts". The new standard establishes the principles for the recognition, measurement, presentation and disclosure of insurance contracts within the scope of the standard. An entity shall apply IFRS 17 "Insurance Contracts" to insurance contracts, including reinsurance contracts, it issues; reinsurance contracts it holds; and investment contracts with discretionary participation features it issues, provided the entity also issues insurance contracts.

IFRS 17 is effective for annual reporting periods beginning on or after January 1, 2021. Earlier application is permitted if both IFRS 15 Revenue from Contracts with Customers and IFRS 9 Financial Instruments have also been applied.

The Management is considering the implications of these standards, their impact on the consolidated financial statements and the timing of its adoption by the Group.

6. RECLASSIFICATIONS

Certain reclassifications have been made to the consolidated financial statements as at December 31, 2016 and 2015 to conform to the presentation as current year presentation provides better view of the consolidated statement of the financial position and consolidated statement of comprehensive income of the Group.

7. BALANCES AND TRANSACTIONS WITH RELATED PARTIES

Related parties are defined in IAS 24 "Related Party Disclosures". Parties are generally considered to be related if one party has the ability to control the other party, is under common control, or can exercise significant influence or joint control over the other party in making financial and operational decisions. In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form. The Group's immediate parent and ultimate controlling party is the Government of Azerbaijan.

The Group applied the exemption in paragraph 25 of IAS 24 "Related Party Disclosures" regarding the disclosure requirement for government related entities.

A reporting entity is exempt from the disclosure requirements of paragraph 18 of IAS 24 "Related Party Disclosures" in relation to related party transactions and outstanding balances, including commitments, with:

(a) a government that has control or joint control of, or significant influence over, the reporting entity; and
(b) another entity that is a related party because the same government has control or joint control of, or significant influence over, both the reporting entity and the other entity.

The nature of transactions with government related entities include purchase of electricity, borrowings, government investments, sales, construction services, rendering and receiving other services, etc.

Compensation paid to directors for their services in full or part-time executive management positions is made up of a contractual salary. During the years ended December 31, 2016 and 2015 the remuneration of members of the key management included salaries and compensations classified as short-term in accordance with IAS 19 "Employee Benefits".

During the year ended December 31, 2016, the remuneration of key management personnel included salaries, discretionary bonuses and other short-term benefits totaling AZN 305 thousand (2015: AZN 230 thousand).

(In thousands of Azerbaijani Manats unless otherwise indicated)

8. PROPERTY, PLANT AND EQUIPMENT

Movements in the carrying amount of property, plant and equipment were as follows:

	Super-structure	Roadbed	Railway vehicles	Buildings and similar constructions	Operating equipment	Construction in progress	Other	Total
Initial cost								
January 1, 2015	**1,356,083**	**539,61**	**227,830**	**234,606**	**90,393**	**287,711**	**13,776**	**2,750,011**
Additions	1,302	-	233,713	13,743	6,128	235,251	2,162	492,299
Internal transfer	67,232	-	-	-	-	(67,232)	-	-
Disposals	(1,446)	-	(836)	(243)	(40)	-	(421)	(2,986)
Effect of translation to presentation currency	59	-	-	118	20	-	903	1,100
December 31, 2015	**1,423,230**	**539,61**	**460,707**	**248,224**	**96,501**	**455,730**	**16,420**	**3,240,424**
Additions	632	200	87,246	13,694	58,171	689,018	3,806	852,767
Internal transfer	75,849	-	-	-	-	(75,849)	-	-
Disposals	(11,933)	-	(1,393)	(462)	(367)	-	(101)	(14,256)
Effect of translation to presentation currency	63	-	-	178	19	-	965	1,225
December 31, 2016	**1,487,841**	**539,81**	**546,560**	**261,634**	**154,324**	**1,068,899**	**21,090**	**4,080,160**
Accumulated depreciation								
January 1, 2015	**(238,652)**	**(23,864)**	**(82,057)**	**(21,413)**	**(33,778)**	**-**	**(6,924)**	**(406,688)**
Charge for the year	(75,767)	(5,966)	(30,820)	(6,455)	(10,368)	-	(3,187)	(132,563)
Impairment charge	(98,712)	(41,371)	-	(19,613)	(4,659)	(40,519)	(581)	(205,455)
Eliminated on disposal	1,446	-	836	243	40	-	421	2,986
Effect of translation to presentation currency	(3)	-	-	(3)	(1)	-	(191)	(198)
December 31, 2015	**(411,688)**	**(71,201)**	**(112,041)**	**(47,241)**	**(48,766)**	**(40,519)**	**(10,462)**	**(741,918)**
Charge for the year	(79,039)	(5,991)	(50,820)	(6,790)	(13,926)	-	(3,375)	(159,941)
Impairment charge	(82,710)	(37,746)	-	(17,119)	(7,496)	(83,723)	(591)	(229,385)
Eliminated on disposal	7,372	-	558	462	246	-	78	8,716
Effect of translation to presentation currency	(3)	-	-	(3)	(1)	-	(126)	(133)
December 31, 2016	**(566,068)**	**(114,93**	**(162,303)**	**(70,691)**	**(69,943)**	**(124,242)**	**(14,476)**	**(1,122,661)**
Net book value:								
December 31, 2016	**921,773**	**424,87**	**384,257**	**190,943**	**84,381**	**944,657**	**6,614**	**2,957,499**
December 31, 2015	**1,011,542**	**468,41**	**348,666**	**200,983**	**47,735**	**415,211**	**5,958**	**2,498,506**

During the year ended December 31, 2016 the Group purchased and put into use two ballast dozer, two machines with towing and buffer equipment, a machine for renewal of ties, a dynamic stabilizer on the rail track of the railway between Baku and Beyuk-Kyasik and two Stadler 4-Car double deck electrical multiple units type KISS trains on Baku-Sumgait mainline track. The operations were financed by the loan attracted from HSBC Bank plc and "Credit Suisse" AG.

During the years ended December 31, 2016 and December 31, 2015 the Group also purchased and put into use 600 tank wagons for oil and petroleum products, 401 covered wagons, 1000 open-top wagons, 400 multi-purpose flat wagons, 300 grain wagons, 100 cement hopper wagon, 200 container flat wagon and 100 ballast hopper wagon from UVZ International s.a.r.l.

Ten diesel locomotives have been leased from Hanseatic Rail LLC and put into use during the year ended December 31, 2016.

During the year ended December 31, 2015 the Group purchased and put into use three Stadler 4-Car double deck electrical multiple units type KISS trains on Baku-Sumgait mainline track. The operation was financed by the loan attracted from Credit Suisse AG.

Disposal of property, plant and equipment was partly written off through profit or loss under loss on disposal of property, plant and equipment and partly written-off to the inventory account.

As described in Note 3, as at December 31, 2016, the Group performed impairment test for certain CGUs and as a result recognized impairment losses for property, plant and equipment during 2016 in the amount of AZN 229,386 thousand (2015: AZN 205,455 thousand).

As at December 31, 2016 and 2015, property, plant and equipment with the carrying amounts of AZN 118,671 thousand (EUR 63,651 thousand as per contract), AZN 14,945 thousand and AZN 5,482 thousand (USD 3,096 thousand as per contract) were pledged as collateral under the borrowings obtained from Credit Suisse AG, "Demir Bank" OJSC and "Azer Turk Bank" OJSC, respectively.

Property, plant and equipment as at December 31, 2016 include borrowing costs incurred in connection with the construction of property, plant and equipment. Borrowing costs capitalized as property, plant and equipment during 2016 amounted to AZN 4,841 thousand (2015: AZN 2,378 thousand).

The historical cost of items held under finance leases at December 31, 2016 and 2015 was AZN 79,091 thousand. Additions during the year ended December 31, 2015 include AZN 50,242 thousand of railway vehicles under finance leases. Leased assets are pledged as security for the related finance lease.

(In thousands of Azerbaijani Manats unless otherwise indicated)

9. INTANGIBLE ASSETS

	Intangible assets
Initial cost	
January 1, 2015	**440**
Additions	390
Disposals	(315)
December 31, 2015	**515**
Additions	82
December 31, 2016	**597**
Accumulated amortization	
January 1, 2015	**(114)**
Amortization charge	(69)
Eliminated on disposal	112
December 31, 2015	**(71)**
Amortization charge	(106)
December 31, 2016	**(177)**
Net book value:	
December 31, 2016	**420**
December 31, 2015	**444**

10. PREPAYMENT FOR PROPERTY, PLANT AND EQUIPMENT

The prepayment for property, plant and equipment in the amount of AZN 325,114 thousand as at December 31, 2016 mainly represents the outstanding prepayments related to the purchase of 50 units of freight locomotives from Alstom Transportand S.A., 30 units of railroad passenger cars from "Stadler", as well as works and services for a complete refurbishment of 600 km of the rail track of the railway between Baku and Beyuk-Kyasik (as at December 31, 2015 outstanding prepayments in the amount of AZN 188,314 thousand included the prepayments related to the "Construction of Baku-Tbilisi-Kars railway route").

(In thousands of Azerbaijani Manats unless otherwise indicated)

11. INCOME TAXES

The Group measures and records its current income tax payable and its tax bases related to assets and liabilities in accordance with the statutory tax regulations of the Republic of Azerbaijan and the Republic of Georgia where the Group operates, which differ from IFRS.

The Group is subject to certain permanent tax differences due to non-tax deductibility of certain expenses and certain income being treated as non-taxable for tax purposes.

Deferred taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for tax purposes. Temporary differences as at December 31, 2016 and 2015 relate mostly to different methods/timing of income and expense recognition as well as to temporary differences generated by taxation bases' differences for certain assets.

Tax legislation of the CIS region in particular may give rise to varying interpretations and amendments. In addition, as management's interpretation of tax legislation may differ from that of the tax authorities, transactions may be challenged by the tax authorities, and as a result the Group may be assessed additional taxes, penalties and interest which could be material for these financial statements.

Temporary differences as at December 31, 2016 and 2015 comprise:

	December 31, 2016	December 31, 2015
Deductible temporary differences:		
Tax losses carry forward	653,802	468,088
Other non-current liabilities	22,822	27,790
Loans receivable	114,209	85,079
Trade and other payables	12,517	5,137
Other current assets	23,727	17,412
Borrowings	12,763	2,967
Trade and other receivables	90,868	41,344
Inventories	6,126	6,643
Total deductible temporary differences	**936,834**	**654,460**
Taxable temporary differences:		
Property, plant and equipment	(675,133)	(958,636)
Total taxable temporary differences	**(675,133)**	**(958,636)**
Net deductible/(taxable) temporary differences	261,701	(304,176)
Net deferred tax asset/(liability) at the statutory tax rate (20%)	52,340	(60,835)
Deferred tax asset not recognized	(49,238)	(5,558)
Net deferred tax asset/(liability)	**3,102**	**(66,393)**

(In thousands of Azerbaijani Manats unless otherwise indicated)

Relationships between tax benefit and accounting loss for the year ended December 31, 2016 and 2015 are explained as follows:

	Year ended December 31, 2016	Year ended December 31, 2015
Loss before income tax	**(565,636)**	**(864,497)**
Theoretical tax charge at statutory rate of 20%	113,127	172,899
Change in deferred tax assets not recognized	(43,680)	(1,186)
Tax effect of permanent differences	(497)	(584)
Income tax benefit	**68,950**	**171,129**
Current income tax expense	(545)	(1,390)
Deferred income tax benefit	69,495	172,519
Income tax benefit	**68,950**	**171,129**

Deferred income tax asset/(liability)	December 31, 2016	December 31, 2015
Beginning of the period	**(66,393)**	**(238,912)**
Change in the deferred income tax liability for the period charged to profit and loss accounts	69,495	172,519
End of the period	**3,102**	**(66,393)**

12. INVENTORIES

	December 31, 2016	December 31, 2015
Spare parts and construction materials	57,449	39,536
Inventories held for sale	11,491	32,839
Fuel	961	1,565
Office supplies	100	70
Uniforms	99	137
Other	489	699
Less: Provision for obsolete and damaged inventories	(12,500)	(33,777)
Total inventories	**58,089**	**41,069**

(In thousands of Azerbaijani Manats unless otherwise indicated)

Movements of provision for obsolete and damaged inventories are as follow:

	December 31, 2016	December 31, 2015
Provision at the beginning of the year	(33,777)	(32,765)
Loss on damaged and obsolete inventories	(70)	(1,012)
Write-off of assets	21,347	-
Provision at the end of the year	**(12,500)**	**(33,777)**

13. LOANS RECEIVABLE

	December 31, 2016	December 31, 2015
Loans receivable	175,027	162,660
Less: Provision for impairment losses	(114,210)	(85,079)
Total loans receivable	**60,817**	**77,581**

As at December 31, 2016 the Group had loans receivable in the amount of AZN 175,027 thousand (2015: AZN 162,660 thousand). The management provided allowance against these receivables as at December 31, 2016 and 2015 in the amount of AZN 114,210 thousand and AZN 85,079 thousand, respectively.

The net amount represents interest free loans granted to the entities in the amount of AZN 43,697 thousand (2015: AZN 64,138 thousand) and interest bearing loans (12% annual) granted to the entities regarding construction of Baku-Tbilisi-Kars railway route in the amount of AZN 17,120 thousand (2015: AZN 13,443 thousand) as at December 31, 2016.

14. TRADE AND OTHER RECEIVABLES

	December 31, 2016	December 31, 2015
Receivables for cargo services	110,518	97,087
Receivables for other services	8,454	7,201
Receivables for construction services	1,947	2,125
Receivables for security services	445	126
Receivables for rent and maintenance services provided	-	78
Other receivables	1,066	887
Less: Provision for bad debt	(90,868)	(41,344)
Total trade and other receivables	**31,562**	**66,160**

(In thousands of Azerbaijani Manats unless otherwise indicated)

Movements of allowance for bad debts recognized for receivables are as follow:

	December 31, 2016	December 31, 2015
Allowance for bad debts at the beginning of the year	(41,344)	(4,124)
Reversal of bad debt expense	2,102	2,524
Recovery of assets previously written off	(3,420)	-
Bad debt expense	(48,206)	(39,744)
Allowance for bad debts at the end of the year	**(90,868)**	**(41,344)**

15. CASH AND CASH EQUIVALENTS

	December 31, 2016	December 31, 2015
Cash in bank accounts	146,989	7,870
Cash on hand	768	249
Total cash and cash equivalents	**147,757**	**8,119**

16. OTHER CURRENT ASSETS

	December 31, 2016	December 31, 2015
Prepayment for inventories and services	89,695	58,500
Input VAT	5,270	9,921
Prepaid expenses	721	848
Advances to employees	362	99
Other prepaid taxes	8	37
Less: Provision for impairment	(30,840)	(24,525)
Total other current assets	**65,216**	**44,880**

Prepayments for inventories and services mainly comprise prepayments for the inventories and services related to the refurbishment of 600 km of the rail track of the railway between Baku and Beyuk-Kyasik, Baku-Sumgait mainline track and Baku-Tbilisi-Kars railway route.

17. BORROWINGS

The borrowings as at December 31, 2016 comprise:

Lender name	Effective interest rate	Initial disbursed amount in Original CCY in thousands	CCY type	Outstanding amount in AZN in thousands	Origination date per contract/ amendment	Final Maturity date
BNP Paribas (Suisse) S.A.						
Loan 1	Libor+3.75%	180,000	USD	178,602	28-Sep-2015	28-Feb-2020
VTB Bank Austria						
Loan 1	5.75%	195,000	USD	169,986	13-Feb-2014	25-Feb-2019
Credit Suisse AG						
Loan 1	Euribor+1.15%	73,735	EUR	117,140	15-Jun-2015	31-Jan-2030
Loan 2	Euribor+3%	11,194	EUR	13,845	15-Jun-2015	30-Jun-2020
HSBC Bank plc						
Loan 1	Euribor+1%	174,650	EUR	325,618	14-Apr-2015	30-Jun-2025
Cargill Financial Services International, Inc.						
Loan 1	Libor+5.5%	13,689	USD	24,239	29-Dec-2016	15-Dec-2017
Loan 2	Libor+5.5%	13,689	USD	24,239	29-Dec-2016	19-Dec-2017
Loan 3	Libor+5.5%	10,936	USD	19,365	29-Dec-2016	22-Dec-2017
Loan 4	Libor+5.5%	8,745	USD	15,485	29-Dec-2016	27-Dec-2017
Loan 5	Libor+5.5%	10,936	USD	19,365	29-Dec-2016	29-Dec-2017
Ceska Sporitelna S.A						
Loan 1	Euribor+1.45%	61,279	EUR	114,561	25-Feb-2016	2-Feb-2022
Ceskoslovenska Obchodni S.A						
Loan 1	Euribor+1.45%	65,885	EUR	122,921	26-Feb-2016	26-Aug-2022
Societe Generale						
Loan 1	Euribor+1%	99,698	EUR	186,181	30-Mar-2016	15-Oct-2031
"Kapital Bank" OJSC						
Loan 1	4.3%	50,000	USD	85,849	11-Feb-2016	11-Feb-2019
Loan 2	5.4%	94,990	USD	168,198	5-Apr-2016	5-Apr-2019
Loan 3	5.4%	14,749	USD	7,871	5-Apr-2016	3-Jun-2016
"International Bank of Azerbaijan" OJSC						
Loan 1	16%	10,000	AZN	7,779	3-Mar-2014	3-Mar-2016
Loan 2	4.5%	59,697	USD	45,880	11-Mar-2014	11-Mar-2017
Loan 3	16%	193	USD	342	3-Feb-2015	3-Feb-2016
Loan 4	3%	35,000	USD	59,628	30-Oct-2015	30-Apr-2017
"Demir Bank" OJSC						
Loan 1	14%	7,500	USD	7,947	24-Feb-2015	31-Dec-2017
"Azer Turk Bank" OJSC						
Loan 1	8%	3,000	USD	5,312	25-Aug-2015	25-Aug-2016
"Karvan Logistics" LLP						
Loan 1	0%	15,455	EUR	28,815	17-May-2016	17-May-2026
The Government of the Republic of Azerbaijan						
Loan 1	Libor+Variable Spr	18,058	USD	31,975	18-Sep-2009	15-Dec-2030
Loan 2	0.2%	39,739	EUR	74,089	1-Nov-2015	31-Jul-2021
Loan 3	0%	10,000	EUR	18,644	7-Apr-2016	7-Apr-2020
TOTAL				**1,873,876**		

The borrowings as at December 31, 2015 comprise:

Lender name	Effective interest rate	Initial disbursed amount in Original CCY in thousands	CCY type	Outstanding amount in AZN in thousands	Origination date per contract/amendment	Final Maturity date
BNP Paribas (Suisse) S.A.						
Loan 1	Libor+3%	180,000	USD	213,453	28-Sep-2015	28-Feb-2020
VTB Bank Austria						
Loan 1	5.15%	195,000	USD	157,200	13-Feb-2014	25-Feb-2019
Credit Suisse AG						
Loan 1	Euribor+1.15%	52,094	EUR	70,757	15-Jun-2015	31-Jan-2030
Loan 2	Euribor+3%	11,194	EUR	16,275	15-Jun-2015	30-Jun-2020
HSBC Bank plc						
Loan 1	Euribor+1%	43,799	EUR	74,832	14-Apr-2015	30-Jun-2025
"International Bank of Azerbaijan" OJSC						
Loan 1	16%	10,000	AZN	8,716	3-Mar-2014	3-Mar-2016
Loan 2	4.5%	59,697	USD	41,836	11-Mar-2014	11-Mar-2017
Loan 3	16%	193	USD	338	3-Feb-2015	3-Feb-2016
Loan 4	10%	150	AZN	150	29-Oct-2015	29-Jan-2016
Loan 5	3%	35,000	USD	54,584	30-Oct-2015	30-Apr-2017
Loan 6	3%	5,000	USD	7,798	30-Oct-2015	30-Apr-2017
Loan 7	10%	110	AZN	63	4-Dec-2015	3-Jun-2016
"International Bank of Azerbaijan-Georgia" OJSC						
Loan 1	16%	3,000	USD	612	24-May-2013	24-May-2016
Loan 2	16%	4,300	GEL	600	18-Nov-2014	5-Mar-2016
"Kapital Bank" OJSC						
Loan 1	4.5%	15,000	AZN	3,936	25-Aug-2011	10-Sep-2016
Loan 2	4.5%	7,000	AZN	7,310	23-Dec-2011	10-Sep-2016
Loan 3	5.4%	5,000	USD	5,285	3-Apr-2015	3-Apr-2016
Loan 4	10%	15,000	USD	17,554	27-May-2015	27-May-2017
Loan 5	5.4%	73,000	USD	106,772	28-Aug-2015	28-Aug-2018
Loan 6	5.4%	10,750	USD	18,753	27-Oct-2015	13-Mar-2018
"Demir Bank" OJSC						
Loan 1	14%	7,500	USD	6,998	24-Feb-2015	24-Feb-2016
"Azer Turk Bank" OJSC						
Loan 1	8%	3,000	USD	4,605	25-Aug-2015	25-Aug-2016
Central Bank of the Republic of Azerbaijan (through International Bank of Azerbaijan OJSC)						
Loan 1	1%	46,000	AZN	46,140	15-Jul-2015	15-Jul-2025
The Government of the Republic of Azerbaijan						
Loan 1	Libor+Variable Spr	21,534	USD	26,541	18-Sep-2009	15-Dec-2030
Loan 2	0.2%	39,739	EUR	67,755	1-Nov-2015	31-Jul-2021
TOTAL				**958,863**		

BNP Paribas (Suisse) S.A.

In 2008, the Group signed a long term loan facility agreement with "BNP Paribas" (Suisse) S.A. for the amount of USD 220,000 thousand with two tranches. The attracted funds were directed towards (a) the purchase of transport and other capital equipment, (b) short-term debt refinancing, (c) general corporate purposes and (d) to pay any commitment fees.

In 2010, the Group signed an addendum to the main agreement and the loan facility amount was amended to the USD 295,000 thousand with two additional tranches.

On December 1, 2014, BNP Paribas, Sumitomo Mitsui Banking Corporation Europe limited, Siemens Bank Gmbh, Banque Cantonale de Geneve (BCGE) provided credit line in the amount of USD 180,000 thousand, in order to reorganize debt finance of the Group and on September 28, 2015, the Group signed an addendum to the credit line agreement and payment terms were amended.

The information about effective interest rates are described in the table above.

The Group is obliged to comply with certain financial covenants as stipulated in the loan agreement signed with "BNP Paribas" (Suisse) S.A. The Group failed to comply with some financial covenants stipulated in the loan agreement as at December 31, 2016 and 2015. The Management believes that breach of covenants would not lead to early withdrawal of these borrowings and therefore these borrowings are classified according to their original payment schedules in the liquidity analysis. Please also refer to Note 35.

During the year ended December 31, 2015 the Group refinanced its loan from "Aquarius Investments Luxembourg S.A" by the amount available from the credit line. No payment of funds was conducted in order to perform this transaction.

VTB Bank (Austria) AG

In 2013, the Group entered into USD 120,000 thousand and USD 20,000 thousand loan agreement and supplemental agreement, respectively with VTB Bank (Austria) AG. The amounts borrowed were partly utilized in financing of capital expenditure of the Group and restructuring of other borrowings with higher interest rates. In 2014, the Lender agreed to increase the amount of facility to USD 195,000 thousand by making available to the Group a further loan in an aggregate of USD 55,000 thousand.

The loan matures in February 2019 and bears annual interest rate of 5.75%.

The Group is obliged to comply with certain financial covenants as stipulated in the loan agreement signed with VTB Bank (Austria) AG. The Group failed to comply with some financial covenants stipulated in the loan agreement as at December 31, 2016 and 2015. The Management believes that breach of covenants would not lead to early withdrawal of these borrowings and therefore these borrowings are classified according to their original payment schedules in the liquidity analysis. Please also refer to Note 35.

Credit Suisse AG

On June 15, 2015 the Group signed an export credit facility agreement with Credit Suisse AG for the amount of up to EUR 73,735 thousand. The amounts borrowed were used for the financing of five Stadler 4-Car double deck electrical multiple units type KISS trains. The loan matures in 2030 and bears annual interest rate of Euribor + 1.15%.

On June 15, 2015 the Group also signed a commercial loan agreement with Credit Suisse AG for the amount of up to EUR 11,194 thousand in connection with the financing of five Stadler 4-Car double deck electrical multiple units type KISS trains. The loan matures in 2020 and bears annual interest rate of Euribor + 3%.

The Group is obliged to comply with certain financial covenants as stipulated in the loan agreement signed with Credit Suisse AG. The Group failed to comply with some financial covenants stipulated in the loan agreement as at December 31, 2016 and 2015. The Management believes that breach of covenants would not lead to early withdrawal of these borrowings and therefore these borrowings are classified according to their original payment schedules in the liquidity analysis.

HSBC Bank plc

On April 14, 2015 the Group signed a credit facility agreement with HSBC Bank plc for the amount of EUR 458,861 thousand. The amounts borrowed were directed for the financing of the rehabilitation of 600 km of the rail track of the railway between Baku and Beyuk-Kyasik. The loan matures in 2025, bears annual interest rate of Euribor + 1% and is guaranteed by the government.

The credit facility in an aggregate amount of EUR 458,861 thousand available in two tranches is as follows:

- a tranche in an aggregate amount of EUR 243,445 thousand, and
- a tranche in an aggregate amount of EUR 215,416 thousand.

The Group is obliged to comply with certain covenants as stipulated in the loan agreement signed with HSBC Bank plc The Group failed to comply with some covenants stipulated in the loan agreement as at December 31, 2016 and 2015. The Management believes that breach of covenants would not lead to early withdrawal of these borrowings and therefore these borrowings are classified according to their original payment schedules in the liquidity analysis.

Cargill Financial Services International, Inc.

On December 29, 2016 the Group signed five credit facility agreements with Cargill Financial Services International, Inc. for the total amount of USD 57,995 thousand. The amounts borrowed were directed for the financing of the construction of railways, reconstruction of rail cars and core activity on provision of transportation services to exporters. All loans mature at the end of 2017 and bear annual interest rate of Libor+5.5%.

The Group is obliged to comply with certain financial covenants as stipulated in the loan agreements signed with Cargill Financial Services International, Inc. The Group failed to comply with some financial covenants stipulated in the loan agreement as at December 31, 2016. The Management believes that breach of covenants would not lead to early withdrawal of these borrowings and therefore these borrowings are classified according to their original payment schedules in the liquidity analysis.

Ceska Sporitelna S.A

On February 25, 2016 the Group signed a credit facility agreement with Ceska Sporitelna S.A. for the amount of EUR 64,051 thousand. The amount borrowed was directed towards the modernisation and reconstruction of up to 50 km Baku-Sumgait mainline track in the Republic of Azerbaijan and delivery of special machinery, technology and services. The loan matures in 2022 and bears annual interest rate of Euribor+1.45%.

The Group is obliged to comply with certain financial covenants as stipulated in the loan agreements signed with Ceska Sporitelna S.A. The Group failed to comply with some financial covenants stipulated in the loan agreement as at December 31, 2016. The Management believes that breach of covenants would not lead to early withdrawal of these borrowings and therefore these borrowings are classified according to their original payment schedules in the liquidity analysis.

Ceskoslovenska Obchodni S.A

On February 26, 2016 the Group signed a credit facility agreement with Ceskoslovenska Obchodni S.A for the amount of EUR 82,000 thousand. The amount borrowed was directed towards the modernisation and reconstruction of 8.3 km railway from Azerbaijan to Iran and delivery of special machinery, technology and services. The loan matures in 2022 and bears annual interest rate of Euribor+1.45%.

The Group is obliged to comply with certain financial covenants as stipulated in the loan agreements signed with Ceskoslovenska Obchodni S.A. The Group failed to comply with some financial covenants stipulated in the loan agreement as at December 31, 2016. The Management believes that breach of covenants would not lead to early withdrawal of these borrowings and therefore these borrowings are classified according to their original payment schedules in the liquidity analysis.

Societe Generale

On March 30, 2016 the Group signed a credit facility agreement with Societe Generale for the amount of EUR 276,995 thousand. The amount borrowed was directed towards the purchase of 50 locomotives from Alstom Transport S.A. The loan matures in 2031 and bears annual interest rate of Euribor+1%.

The loan is disbursed in three tranches as per the schedule below:

- EUR 136,319 thousand to be disbursed by December 2017;
- EUR 78,623 thousand to be disbursed by December 2018;
- EUR 62,053 thousand to be disbursed by November 2019.

The Group is obliged to comply with certain financial covenants as stipulated in the loan agreement signed with Societe Generale. The Group complied with financial covenants stipulated in the loan agreement as at December 31, 2016.

On March 30, 2016 the Ministry of Finance of the Republic of Azerbaijan signed a government guarantee contract with the parties acting as a government guarantor for the Group.

"Kapital Bank" OJSC

On February 11, 2016 and on April 5, 2016 the Group signed credit facility agreements with "Kapital Bank" OJSC for the amounts of USD 50,000 thousand and USD 14,749 thousand, respectively. The amounts borrowed were directed for the enhancement of operations and general corporate purposes. The loans mature in 2019 and bear annual interest rate of 4.3% and 5.4%, respectively.

On April 5, 2016, the Group signed loan restructuring agreement with "Kapital Bank" OJSC to the main agreements signed in the prior years in the amount of USD 10,750 thousand, USD 15,000 thousand, USD 5,000 thousand and USD 73,000 thousand. The loan agreement amount was amended to USD 94,990 thousand with interest rate of 5.4%, which matures in 2019. Please also refer to Note 35.

"International Bank of Azerbaijan" OJSC

In 2014 and 2015 the Group obtained 7 loans from "International Bank of Azerbaijan" OJSC. The amounts borrowed were directed for the financing of capital expenditures, construction of Baku-Tbilisi-Kars railway route and general corporate purposes.

More detailed information about these loans are described in the table above. No financial covenants were stipulated in the borrowing agreements with "International Bank of Azerbaijan" OJSC. Please also refer to Note 35.

Central Bank of the Republic of Azerbaijan (through International Bank of Azerbaijan OJSC)

On July 15, 2015 the Group signed a special purpose loan agreement with the Central Bank of the Republic of Azerbaijan and "International Bank of Azerbaijan" OJSC, acting as arranger for the amount of AZN 46,000 thousand. The amounts borrowed were directed for the financing of the rehabilitation of Baku-Sumgait mainline track. The loan matures in 2025 and bears annual interest rate of 1%.

No covenants were stipulated in the borrowing agreement with this lender.

On July 15, 2015 the Ministry of Finance of the Republic of Azerbaijan signed a government guarantee contract with the parties acting as a government guarantor for the Group.

During the year ended December 31, 2016, the Ministry of Finance of the Republic of Azerbaijan made all principal and interest payments on behalf of the Group and the Group recognised these amounts as government investments.

The Government of the Republic of Azerbaijan

On December 18, 2009, the Government of the Republic of Azerbaijan and the International Bank for Reconstruction and Development (the "IBRD") have agreed to lend a credit facility in the amount equivalent to USD 450,000 thousand in order to finance "Rail Trade and Transport Facilitation project of the Republic of Azerbaijan". The Project's original completion date of September 30, 2013 has been extended to December 31, 2017 on September 17, 2013.

On June 27, 2013, the Government of the Republic of Azerbaijan and the IBRD agreed to restructure the Project by providing additional financing in the amount of USD 220,000 thousand and extending the closing date to December 31, 2017. The additional financing will be used for full replacement of power supply and signalling systems on the East-West Main Line.

The objective of the project is to improve railway services in the Republic of Azerbaijan, as well as the competitiveness, financial sustainability, operating and cost efficiency and capacity of the Group in particular along the east-west transport corridor.

The Project consists of the following components:

Component 1: Rehabilitation of East-West Main Line

Provision of goods, works and services to: (a) rehabilitate about 240 km of mainline track; (b) convert power supply on the East-West Main Line; and (c) upgrade signalling, compatible with new 25kV AC power supply system.

On June 27, 2013 the IBRD and the Government of Republic of Azerbaijan agreed to restructure the Loan Agreement and correspondently, additional 298 km of mainline track was included in the scope of Component 1.

Component 2: New Mainline Locomotives

Provision of goods and services in order to provide mainline 25kV AC electric locomotives to operate on the east-west corridor.

The Government of the Republic of Azerbaijan and IBRD agreed to finance the new mainline locomotives directly using the funds of the Government of Republic of Azerbaijan and requested the IBRD to reallocate USD 202,000 thousand to the rehabilitation of the East-West mainline of Component 1.

Component 3: Modernization of Azerbaijan Railway Services

Provision of goods, works, services and training in order to: (a) support the implementation of the restructuring and development of Azerbaijan Railways, including, but not limited to, for the transition to the IFRS and legal restructuring of the Azerbaijan Railways; and (b) improve its oil spill prevention capacity.

Component 4: Project Implementation

Support of the Project Implementation Unit for effective implementation of the Project, through provision of goods, consultants' services and training.

The loan facility was expected to be used as follows:

	Allocation of the Loan (expressed in thousands USD)				**Percentage of expenditure to be financed by IBRD**
	Original	**Revised Original**	**Additional Financing**	**Total**	
(1) Goods, works, consultants' services, training and incremental operating costs for Component 1 of the Project	232,875	434,875	211,950	646,825	100%
(2) Goods for Component 2 of the Project	202,000	-	-	-	0%
(3) Goods, works, consultants' services, training and incremental operating costs for Components 3 and 4 of the Project	14,000	14,000	7,500	21,500	85%
(4) Front-end fee	1,125	1,125	550	1,675	0.25% of the total disbursement
TOTAL	**450,000**	**450,000**	**220,000**	**670,000**	

Following this agreement, the Group signed project agreement with Government of the Republic of Azerbaijan on the same date and loan agreement with the Government subsequently.

According to the loan agreement, the Group takes obligation for the repayment of financing to be received from IBRD for the Component 3 in the amount of USD 21,500 thousand and for the Component 4 in the amount of USD 54 thousand and related interest costs.

The Government of the Republic of Azerbaijan in its turn takes obligation for the repayment of financing to be received from IBRD for the Component 1 in the amount of USD 646,825 thousand and for the Component 4 in the amount of USD 1,621 thousand and related interest costs.

The interest rate was determined as Libor+Variable Spread. Variable Spread is the rate to be effective on the repayment dates of loan, which is determined by the IBRD semi-annually.

(In thousands of Azerbaijani Manats unless otherwise indicated)

The Group is obliged to comply with certain financial covenants as stipulated in the project agreement in connection with loan agreement signed with IBRD. The Group failed to comply with some financial covenants stipulated in the loan agreement as at December 31, 2016 and 2015.

On November 1, 2015 the Group signed a loan agreement with the Ministry of Finance of the Republic of Azerbaijan for the amount of EUR 39,739 thousand. The amounts borrowed were directed for the financing of the rehabilitation of 600 km of the rail track of the railway between Baku and Beyuk-Kyasik. The loan matures in 2021 and bears annual interest rate of 0.2%.

On April 7, 2016 the Group signed a credit line agreement with the Ministry of Finance of the Republic of Azerbaijan and "International Bank of Azerbaijan" OJSC, acting as arranger for the amount of EUR 10,000 thousand. The amounts borrowed were directed for the financing of the rehabilitation of 600 km of the rail track of the railway between Baku and Beyuk-Kyasik. The loan matures in 2020.

No covenants were stipulated in the borrowing agreement with this lender.

Other loans

In 2016 and 2015 the Group obtained general purpose loans from "Karvan Logistics" LLP " and "Azer-Turk Bank" OJSC, "DemirBank" OJSC, and "International Bank of Azerbaijan-Georgia" OJSC, respectively.

The information about these loans are described in the table above. No financial covenants were stipulated in the borrowing agreements with these lenders.

18. FINANCE LEASE OBLIGATIONS

The Group entered into finance lease agreement with Hanseatic Rail LLC and Hanseatic Transport LLC for purchase of 4 electric locomotives in 2015 and 50 passenger wagons in 2013, respectively. The lease term is 6.5 years and 8.5 years with the effective interest rate of 4% and 12%, respectively. The Group also entered into finance lease agreement with BRK Leasing LLC for purchase of 10 highway diesel locomotives in 2015. The lease term is 10 years with the effective interest rate of 5.85%.

The present value of the net minimum lease payments as at December 31, 2016 and 2015 are as follows:

	December 31, 2016	December 31, 2015
Finance lease liabilities:		
Not later than 1 year	28,793	22,818
Later than 1 year and not later than 5 years	87,671	98,720
Total minimum lease payments	**116,464**	**121,538**
Less: unearned finance income	(19,910)	(24,207)
Total	**96,554**	**97,331**
Representing lease liabilities:		
Current	21,633	15,502
Non-current	74,921	81,829
Total	**96,554**	**97,331**

(In thousands of Azerbaijani Manats unless otherwise indicated)

Finance charges for the year ended December 31, 2016 amounted to AZN 8,920 thousand (2015: AZN 2,549 thousand) and are included in "finance costs" line in the consolidated statement of comprehensive income.

19. TRADE AND OTHER PAYABLES

	December 31, 2016	December 31, 2015
Payables for property, plant and equipment, current	62,133	39,854
Payables for construction work	59,377	40,157
Trade payables for inventories and other services	46,309	44,394
Payables for other services	46,486	57,483
Payables for electricity	2,909	5,370
Other payables	4,398	3,601
Total trade and other payables, current	**221,612**	**190,859**
Payables for property, plant and equipment, non-current	164,537	158,320
Payables for other services, non-current	10,538	-
Total trade and other payables, non-current	**175,075**	**158,320**

Payables for property, plant and equipment includes interest-bearing payables to UVZ International S.a.r.l. for purchase of new 3,101 multipurpose wagons of various models. The Group received 312 wagons during the year ended December 31, 2016 (2015: 2,789 wagons).

In accordance with Annex #1 to the contract, the supplier provided the Group with an instalment payment opportunity for the period of 5 years at the annual interest rate of 20%.

Payables for other services include payables to Georgian Railways JSC for rent of railway vehicles in the amount of AZN 12,533 thousand as at December 31, 2016.

20. OTHER NON-CURRENT LIABILITIES

	December 31, 2016	December 31, 2015
Provision for construction losses	4,876	13,675
Warranty provision	17,946	14,115
Total other non-current liabilities	**22,822**	**27,790**

21. TAXES PAYABLE OTHER THAN INCOME TAX

	December 31, 2016	December 31, 2015
VAT payable	4,763	6,968
Customs fee payable	4,093	4,093
Social tax payable	1,976	3,739
Personal income tax payable	39	534
Property tax payable	-	31
Total taxes payable other than income tax	**10,871**	**15,365**

22. ADVANCES RECEIVED

The advances received in the amount of AZN 138,324 thousand as at December 31, 2016 represented the outstanding advances related to the "Construction of Baku-Tbilisi-Kars railway route", works and services for a complete refurbishment of 600 km of the rail track of the railway between Baku and Beyuk-Kyasik, as well as advances received for logistic services which will be provided by ADY Express LLC (2015: AZN 139,675 thousand related to the "Construction of Baku-Tbilisi-Kars railway route" and works and services for a complete refurbishment of 600 km of the rail track of the railway between Baku and Beyuk-Kyasik).

23. SHARE CAPITAL

The share capital of the Company as at December 31, 2016 amounted to AZN 726,147 thousand (2015: AZN 726,147 thousand) consisting of 363,074 thousand shares with par value of AZN 2 each (2015: 363,074 thousand shares with par value of AZN 2 each). Please also refer to note 35.

24. GOVERNMENT INVESTMENTS

In order to improve and enhance the operations and the infrastructure of the Group, the Government has allocated subsidies to the Group under the several government programs.

According to the decree # 183 of the Cabinet of the Ministers of the Republic of Azerbaijan dated October 22, 2010, all government investments allocated to the state companies of the Republic of Azerbaijan for the purposes of improvement of infrastructure and enhancement of their operations since 2007 should be included in the share capital of these entities.

As described in Note 2 to the consolidated financial statements in accordance with IFRS, all these subsidies were initially recorded in government investments line in the equity until they are registered in relevant government agencies, the management registered AZN 127,147 thousand of government investment as share capital in 2014. The management of the Group is now working on registering the rest of subsidies as share capital.

The government investments amounted to AZN 946,205 thousand and AZN 607,098 thousand as at December 31, 2016 and 2015, respectively. The investments were as follows:

Reference to the decree of the Cabinet of Ministers and other sources	Purpose of investment	Amount in thousands of AZN
2007-2014		**523,061**
2015		
Decree of Cabinet of Ministers # 424s as at 30-Dec-2014	Share of IBRD in "Rail Trade and Transport Facilitation project"	54,784
	Share of Government in "Rail Trade and Transport Facilitation project"	13,659
Decrees of Cabinet of Ministers # 424s and # 398s as at 30-Dec-2014	Payment of VAT in "Reconstruction of Railways project"	1,696
Decree of Cabinet of Ministers # 424s as at 30-Dec-2014	Reconstruction of a metal bridge over Kur river at 253 km in the "Yevlakh-Malay" direction	2,000
Decree of Cabinet of Ministers # 231s as at 24-July-2015 and Order of Ministry of Finance # i-144	Reconstruction of road infrastructure in "Baku-Sumgait-Baku" route	11,598
Decree of Cabinet of Ministers # 424s as at 30-Dec-2014	Reconstruction of roads, energy supply and communication equipment in Yalama customs station	300
	Total amount for 2015	**84,037**
	Total allocated amount as at December 31, 2015	**607,098**
2016		
Decree of Cabinet of Ministers # 424s as at 30-Dec-2014	Share of IBRD in "Rail Trade and Transport Facilitation project"	111,654
	Share of Government in "Rail Trade and Transport Facilitation project"	22,315
Decrees of Cabinet of Ministers # 424s and # 398s as at 30-Dec-2014	Payment of VAT in "Reconstruction of Railways project"	36,714
Decree of Cabinet of Ministers # 231s as at 24-July-2015 and Order of Ministry of Finance # i-144	Reconstruction of road infrastructure in "Baku-Sumgait-Baku" route	46,000
Decree of Cabinet of Ministers # 95s as at 22-Feb-2016	Repair and construction works on the railways within the "International North-South Transport Corridor", including construction of Astara Azerbaijan-Astara Iran railway	45,000
Decree of Cabinet of Ministers # 95s as at 22-Feb-2016	Share of Government in purchasing 50 units of freight locomotives from Alstom Transport S.A.	77,424
	Total amount for 2016	**339,107**
	Total allocated amount as at December 31, 2016	**946,205**

During the year ended December 31, 2013 and 2012 the Group signed agreement with the third parties regarding the installation of signalling system and power conversion facilities on Baku to Beyuk-Kyasik railway route with estimated cost of USD 288,140 thousand (related taxes approximating of USD 51,860 thousand will be financed by the Government) and USD 337,123 thousand (related taxes approximating of USD 60,682 thousand will be financed by the Government), correspondingly, under the "Rail Trade and Transport Facilitation project" financed by IBRD. The estimated completion date for both projects is 2017. The Government is responsible for repayment of above mentioned loan facility and total investment in these projects will be included in the equity of the Group according to the Group's policy.

(In thousands of Azerbaijani Manats unless otherwise indicated)

In June 2010, the Government of Azerbaijan Republic and Czech Export Bank signed an agreement regarding the financing of the "Construction of 317 km railway route from Baku to Beyuk-Kyasik project" (the "Project") in the amount of EUR 215,000 thousand. Following this loan facility, the Group and Moravia Steel A.S. (the "Supplier") which is a legal entity registered in the Czech Republic, signed an agreement on purchasing materials and services from the Supplier.

Total cost of the project was EUR 252,941 thousand where EUR 215,000 thousand was financed through loan facility and the rest of contract amount approximating of EUR 37,941 thousand and related taxes was financed by the Government. The Government is responsible for repayment of above mentioned loan facility and total investments in this project will be included in the equity of the Group according to the Group's policy. The project was completed at the end of 2014.

After completion of "Construction of 317 km railway route from Baku to Beyuk-Kyasik project", on December 1, 2014, the Group entered into an agreement with the Supplier to supply equipment and materials, and perform related works and services for a "Complete refurbishment of 600 km of the rail track of the railway between Baku and Beyuk-Kyasik". The project commenced in the beginning of 2015 and is planned to be completed in 4.5 years. In order to finance this project the Group signed a loan in the amount of EUR 458,861 thousand from HSBC Bank plc on April 14, 2015.

During the year ended December 31, 2016, the Group received a grant in the amount of AZN 45,000 thousand for the financing of repair and construction works regarding the "International North-South Transport Corridor", including construction of Astara Azerbaijan-Astara Iran railway based on decree of President of the Republic of Azerbaijan #1608 dated December 7, 2015 and decree of Cabinet of Ministers # 95s dated February 22, 2016.

The Group signed an agreement with Societe Generale for the loan in the amount of EUR 276,995 thousand on March 30, 2016. The loan was granted for the purchase of 50 locomotives from Alstom Transport S.A. and is guaranteed by the government. During the year ended December 31, 2016, 15% of the loan agreement was granted by the government in the amount of AZN 77,424 thousand.

On July 24, 2015 the Group received grant in the amount of AZN 11,598 thousand for the financing of the rehabilitation of Baku-Sumgait mainline track.

25. CONSTRUCTION REVENUES AND CONSTRUCTION COSTS

In February 2007, the Republic of Azerbaijan, Georgia and Turkey signed agreement regarding construction of Baku-Tbilisi-Kars railway route. The State Oil Fund of the Republic of Azerbaijan extended financing in the amount of USD 750 million for this project. The Group is rendering construction services through its branch operated in the Republic of Georgia.

Construction revenues and associated construction costs during the year ended December 31, 2016 and 2015 derive from the construction of Baku-Tbilisi-Kars railway route. Total amount of contract is AZN 195,346 thousand.

	Year ended December 31, 2016	**Year ended December 31, 2015**
Construction revenues	61,913	31,930
Construction revenues	**61,913**	**31,930**

(In thousands of Azerbaijani Manats unless otherwise indicated)

	Year ended December 31, 2016	Year ended December 31, 2015
Construction costs, including warranty costs	76,171	49,088
Reversal of construction loss recognized in prior years	(13,080)	(11,240)
Construction costs, net	**63,091**	**37,848**

	December 31, 2016	December 31, 2015
Receivables for construction services	1,947	2,125
Payables for construction work	59,377	40,157

26. OTHER REVENUES

	Year ended December 31, 2016	Year ended December 31, 2015
Revenue from rolling stock operations and maintenance services	17,855	17,629
Revenue from rent of cargo cars, wagons and other properties	3,471	6,521
Revenue from security services	2,038	2,698
Revenue from scrap metal sales	2,025	1,000
Revenue from wagon washing services	387	431
Revenue from water sales	144	129
Revenue from electricity sales	141	300
Others	323	453
Total other revenues	**26,384**	**29,161**

27. TAXES OTHER THAN INCOME TAX

	Year ended December 31, 2016	Year ended December 31, 2015
Social tax	14,334	13,638
Property tax	4,406	2,300
Land tax	3,248	3,254
Other	6	47
Total taxes other than income tax	**21,994**	**19,239**

(In thousands of Azerbaijani Manats unless otherwise indicated)

28. OTHER OPERATING COSTS

	Year ended December 31, 2016	Year ended December 31, 2015
Business trip expenses and trainings	2,572	1,374
Professional services and fees	2,251	2,390
Printing costs	1,237	998
Contribution to trade union and professional associations	1,155	1,059
Water expenses	1,066	1,292
Transportation expenses	970	1,090
Insurance costs	968	710
Sanitation costs	932	417
Office supplies	814	413
Communication costs	583	603
Security expenses	577	306
Commercial expenses	519	201
Customs fees	143	57
Representation costs	140	159
Natural gas expenses	84	200
Vehicle running costs	67	154
Sewerage expenses	52	73
Other	947	449
Total other operating costs	**15,077**	**11,945**

29. BAD DEBT EXPENSE

Bad debt expense during the year ended December 31, 2016 comprises allowances for loans receivable in the amount of AZN 29,131 thousand, allowances for other current assets in the amount of AZN 6,315 thousand, allowance for trade and other receivables in the amount of AZN 48,206 thousand and reversal of allowance for trade and other receivables in the amount of AZN 2,102 thousand (2015: allowances for loans receivable in the amount of AZN 64,136 thousand, allowances for other current assets in the amount of AZN 16,219 thousand, allowance for trade and other receivables in the amount of AZN 39,744 thousand and reversal of allowance for trade and other receivables in the amount of AZN 2,524 thousand).

30. FINANCE COSTS

	Year ended December 31, 2016	Year ended December 31, 2015
Interest on debts and borrowings	51,510	30,468
Finance charges payable under finance leases	8,920	2,549
Total interest expense	**60,430**	**33,017**
Unwinding of discount and effect of changes in discount rate on provisions	4,280	3,054
Total finance costs	**64,710**	**36,071**

31. OTHER INCOME/(EXPENSES)

Other income mainly comprises of gain from extinguishment of liabilities in the amount of AZN 8,392 thousand and other expenses mainly comprises penalties charged by suppliers for the late payments in the amount of AZN 3,119 thousand for the year ended December 31, 2016.

Other income comprises of gain from extinguishment of liabilities in the amount of AZN 4,722 thousand for the year ended December 31, 2015.

32. CONTINGENCIES, COMMITMENTS AND OPERATING RISKS

Legal proceedings

From time to time and in the normal course of business, claims against the Group are received. On the basis of its own estimates and both internal and external professional advice, management is of the opinion that no material losses will be incurred in respect of claims in excess of provisions that have been made in these financial statements.

Tax legislation

Tax, currency and customs legislation in the Republic of Azerbaijan and Commonwealth Independent States ("CIS") region is subject to varying interpretations, and changes, which can occur frequently. Management's interpretation of such legislation as applied to the transactions and activities of the Group may be challenged by the relevant authorities. Recent events within the region suggest that the tax authorities may be taking a more assertive position in their interpretation of the legislation and assessments, and it is possible that transactions and activities that have not been challenged in the past may be challenged. As a result, significant additional taxes, penalties and interest may be assessed.

Fiscal periods remain open to review by the authorities in respect of taxes for three calendar years preceding the year of review. Under certain circumstances, reviews may cover longer periods.

Management believes that its interpretation of the relevant legislation is appropriate and the Group's tax, currency legislation and customs positions will be sustained.

Capital expenditure commitments

As at December 31, 2016 and 2015 the Group's capital commitments were associated with the borrowing facilities and government investment programs. The Group had commitment to the second phase of the installation of the signalling system and power conversion facilities on Baku to Beyuk-Kyasik railway route, Baku-Sumgait mainline track, Astara Azerbaijan-Astara Iran railway route, and purchasing 50 units of locomotives from Alstom Transport S.A.

Finance lease commitments

The Group has finance lease contracts for various items of property, plant and equipment. The Group's obligations under finance leases are secured by the lessor's title to the leased assets. Future minimum lease payments under finance lease contracts, together with the present value of the net minimum lease payments are disclosed in Note 18.

Operating lease contracts are cancellable comprising mainly lease of production equipment and vehicles which are cancellable.

Environmental matters

The enforcement of environmental regulation in the Republic of Azerbaijan and CIS region is evolving and the enforcement posture of government authorities is continually being reconsidered. The Group periodically evaluates its obligations under environmental regulations. As obligations are determined, they are recognized immediately. Potential liabilities, which might arise as a result of changes in existing regulations, civil litigation or legislation, cannot be estimated but could be material. In the current enforcement climate under existing legislation, management believes that there are no significant liabilities for environmental damage.

Tariff Regulation Policy

Potential reforms in tariff-setting policy may have a significant effect on the Group's financial position and results of operations. The Group is continuously discussing the tariff setting policy, including both unification of such tariffs between domestic and foreign transportation and increases in the tariffs, with the Government of the Republic of Azerbaijan.

It is currently uncertain whether and when any further changes will be introduced in the tariff setting policy. These consolidated financial statements do not include any adjustments that might result from these uncertain effects. Such adjustments, if any, will be reported in the Group's consolidated financial statements in the period when they become known and estimable.

Operating environment of the Group

The Group's operations are conducted in the Republic of Azerbaijan. As an emerging market, at the present time the Republic of Azerbaijan is developing business and regulatory infrastructure that would generally exist in a more mature market economy.

Major macroeconomic indicators of the Azerbaijan's economy were influenced by a number of negative factors. Considering significant drop in crude oil prices starting from the second half of 2014, there continues to be uncertainty regarding the economic growth, access to capital and cost of capital in the Republic of Azerbaijan, because Azerbaijan produces and exports large volumes of oil and gas, its economy is particularly dependent on the price of oil and gas. Economic growth slowed down in 2014 and 2015 approximately 2% and 1.1%, respectively and turned negative 3% in 2016. These factors resulted in the economic slowdown to shift from prosperity to recession economy with high inflation and unemployment and decreasing GDP.

The future economic growth of the Republic of Azerbaijan is largely dependent upon the effectiveness of economic, financial and monetary measures undertaken by the Government, together with tax, legal, regulatory and political developments. The Management is unable to predict, all developments in the economic environment which would have an impact on the Group's operations and consequently what effect, if any, they could have on the financial position of the Group.

Decreasing revenues from oil exports made the Central Bank of the Republic of Azerbaijan abandon its peg policy to the basket of US dollars and Euros. In addition, CBAR devalued the Azerbaijani Manat by approximately 34% on February 21, 2015 and further on December 21, 2015 introduced a floating exchange rate that resulted in one-time devaluation of the AZN against US dollars and other major currencies by approximately 48%. The devaluation of Azerbaijani Manat continued in 2016 and resulted in 14% fall against US dollars and 9% fall against Euro by December 31, 2016. In January 2016, Standard & Poor's, international credit agency, downgraded long-term and short-term foreign and national currency sovereign rating to the speculative level. Starting from February, 2016 the Central Bank of the Republic of Azerbaijan has gradually increased refinancing rate from 3% to 15% and the minimum capital adequacy ratio was lowered from 12% to 10%. In addition, CBAR prevented speculations in the currency market by setting a limit on the currency exchange rate corridor within 4% of the official rate which was revoked in 2017 and introduced limits on the amount of foreign currency exchange.

The Azerbaijani economy is vulnerable to market downturns and economic slowdowns elsewhere in the world. While the Government has introduced a range of stabilization measures and plans to expedite reforms and support to banking system in response to current economic challenges. The Management believes it is taking appropriate measures to support the sustainability of the Group's business in the current circumstances, unexpected further deterioration in the areas described above could negatively affect the Group's results and financial position in manner not currently determinable.

Amidst the ongoing crisis, the government of Azerbaijan shifted its oil-oriented economic policy, dominated for two decades, to the diversification of the economy. For that purpose, a "national strategic roadmap" was adopted to formulate a correct development strategy. The implementation of the "national strategic roadmap" was assigned to the newly formed "Center for Analysis of Economic Reforms and Communications," the aim of which is analyzing the effectiveness of conducted reforms and making new proposals.

Significant measures have been taken in custom services and taxation as well. As of August 1, 2016, new regulations to ensure more operative and transparent custom clearance (a "green corridor" and other access systems) were implemented. The new simplified procedures are intended to stimulate imports and provide favorable conditions for business and external trade. As a continuation of reforms in customs, the reception of e-declarations is introduced minimize the contact of citizens with government officials. In order to amend the existing tax system, the decree approving the "Directions of Reforms in Taxation for 2016" was signed. The presidential decree requires the Ministry of Taxes to ensure that on-site and off-tax audits are performed within short periods of time and extend the coverage of electronic tax audits to limit face-to-face contacts with taxpayers. Another important amendment on monopolistic actions was made to the Criminal Code. Besides, the latest changes in December 2016 to Taxes Code "transfer pricing" will be applied against artificially exaggerated expenses and "voluntary tax disclosure" notion included in the Code which is highly practicable in greatest economies. Furthermore, in order to prevent additional exposure to financial sanctions by the tax authority because of tax liability miscalculation, the mechanism of "determination of tax liability in advance" principle will be in force. Along with them, implementation of electronic invoices will play an important role in prevention of tax evasion and will impact positively on tax system optimization.

The recession is expected to be short-lived, transforming to economic growth in 2017, partly due to positive effects of investments in gas projects. It is estimated that the GDP will grow 1.4% and the non-oil sector will expand about 2.4%. Over the long term, Azerbaijan will benefit from production from the new gas fields, which is expected to commence in 2018.

Insurance

The Republic of Azerbaijan and CIS region insurance industry is in a developing stage: insurance market capacity and low variety of product line does not completely meet customers' requirements. Compulsory insurance common in other parts of the world is being introduced in stages and may not be available for some types of insurance.

Management has not approved insurance policy for the Group which sets general principles for the Group in respect of major terms of insurance contracts.

During the year ended December 31, 2016 and 2015, the Group did not maintain insurance coverage regarding major categories of its property. The Group did not maintain insurance coverage on business interruption as management assessed insurance expenses to be significantly higher than potential losses associated with this risk.

(In thousands of Azerbaijani Manats unless otherwise indicated)

33. FINANCIAL RISK MANAGEMENT

The Group's principal financial instruments comprise bank loans, cash and bank deposits. The main purpose of these instruments is to raise finance for the Group's operations.

The Group has other financial assets and liabilities such as trade receivables and trade payables, which arise directly from its operations. The Group is exposed to credit and liquidity risks and market risk. Financial risks are monitored by Corporate Finance Department of the Group. Credit, currency and interest rate risks are regulated by corporate financial risks management policies. The Company also maintains centralized financial risk management policy at all subsidiaries.

Credit Risk

Credit risk is the risk that a counter party will fail to discharge an obligation and cause the Group to incur a financial loss. Cash is placed in financial institutions, which are considered at a time of deposit to have minimal risk of default. Management monitors the creditworthiness of the banks in which it deposits cash and ensures that the deposits placed by ADY in each financial institution do not exceed approved upper limit. These limits are recalculated quarterly in accordance with corporate policies, which include qualitative and quantitative analysis of financial institutions' performance.

These limits are monitored and approved by the Company's Corporate Finance Department. Financial assets, which potentially subject the Group to credit risk, consist principally of trade receivables and loans receivables. The carrying amount of these financial assets, net of impairment, represents the maximum amount exposed to credit risk. With the exception for the matters discussed below, the Group has no significant concentrations of credit risk. Although collection of receivables could be influenced by economic factors, management believes that there is no significant risk of loss to the Group beyond the impairment already recorded.

The maximum exposure to credit risk is equal to the carrying amount of financial assets as at December 31, 2016 and 2015 which is disclosed below:

	December 31, 2016	December 31, 2015
Financial assets:		
Loans receivable	60,817	77,581
Trade and other receivables	31,562	66,160
Cash and cash equivalents (excluding cash on hand)	146,989	7,870
	239,368	**151,611**

Maximum exposure of credit risk

The Group's maximum exposure to credit risk varies significantly and is dependent on both individual risks and general market economy risks.

Financial assets are graded according to the current credit rating they have been issued by an internationally regarded agency such as Fitch Rating. The highest possible rating is AAA. Investment grade financial assets have ratings from AAA to BBB. Financial assets which have ratings lower than BBB are classed as speculative grade.

The following table details credit ratings of financial assets held by the Group as at December 31, 2016 and 2015 (this information is prepared for all financial assets that are neither past due nor impaired):

(In thousands of Azerbaijani Manats unless otherwise indicated)

	BB	BB-	Not Rated	December 31, 2016 Total
Loans receivable	-	-	60,817	**60,817**
Trade and other receivables	-	-	31,562	**31,562**
Cash and cash equivalents	498	-	147,259	**147,757**

	BB	BB-	Not Rated	December 31, 2015 Total
Loans receivable	-	-	77,581	**77,581**
Trade and other receivables	-	-	66,160	**66,160**
Cash and cash equivalents	1,241	800	6,078	**8,119**

Geographical risk concentration

The Management exercises control over the risk in the legislation and regulatory areas and assesses its influence on the Group's activities. This approach allows the Group to minimize potential losses from the investment climate fluctuations in the Republic of Azerbaijan and CIS region.

The geographical concentration of financial assets and financial liabilities is set out below:

	The Republic of Azerbaijan	OECD countries	Other non-OECD countries	December 31, 2016 Total
FINANCIAL ASSETS				
Loans receivable	60,817	-	-	60,817
Trade and other receivables	31,053	20	489	31,562
Cash and cash equivalents	147,400	-	357	147,757
TOTAL FINANCIAL ASSETS	**239,270**	**20**	**846**	**240,136**
FINANCIAL LIABILITIES				
Borrowings	542,331	1,331,545	-	1,873,876
Finance lease obligations	-	56,246	40,308	96,554
Trade and other payables	47,648	18,746	330,293	396,687
Salaries payable	6,497	-	797	7,294
TOTAL FINANCIAL LIABILITIES	**596,476**	**1,406,537**	**371,398**	**2,374,411**
NET POSITION	**(357,206)**	**(1,406,517)**	**(370,552)**	**(2,134,275)**

(In thousands of Azerbaijani Manats unless otherwise indicated)

	The Republic of Azerbaijan	OECD countries	Other non-OECD countries	December 31, 2015 Total
FINANCIAL ASSETS				
Loans receivable	77,581	-	-	77,581
Trade and other receivables	64,905	-	1,255	66,160
Cash and cash equivalents	6,966	-	1,153	8,119
TOTAL FINANCIAL ASSETS	**149,452**	**-**	**2,408**	**151,860**
FINANCIAL LIABILITIES				
Borrowings	398,593	559,058	1,212	958,863
Finance lease obligations	-	52,308	45,023	97,331
Trade and other payables	52,113	1,123	295,943	349,179
Salaries payable	5,322	-	908	6,230
TOTAL FINANCIAL LIABILITIES	**456,028**	**612,489**	**343,086**	**1,411,603**
NET POSITION	**(306,576)**	**(612,489)**	**(340,678)**	**(1,259,743)**

Liquidity risk

Liquidity risk is the risk that the Group will not be able to meet its financial obligations as they fall due. The Group's approach to managing liquidity is to ensure that it will always have sufficient liquidity to meet its liabilities when due without incurring unacceptable losses or risking damage to the Group's reputation.

The Group manages liquidity risk by maintaining adequate cash reserves and borrowing facilities, by continuously monitoring forecast and actual cash flows and matching the maturity profiles of financial assets and liabilities.

The Group prepares a financial plan on a monthly basis which ensures that the Group has sufficient cash on demand to finance expected operational expenses, financial obligations and investing activities. The Group developed standard payment periods in respect of trade accounts payable and monitors the timeliness of payments to its suppliers and contractors.

The following tables summarize the maturity profile of the Group's financial liabilities based on contractual payment terms. Repayments, which are subject to notice, are treated as if notice were to be given immediately. Accordingly, the related liabilities were reported as payable within less than 1 year.

(In thousands of Azerbaijani Manats unless otherwise indicated)

	Up to 1 month	1 month to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	December 31, 2016 Total
FINANCIAL ASSETS						
Loans receivable	60,817	-	-	-	-	60,817
Trade and other receivables	31,562	-	-	-	-	31,562
Cash and cash equivalents	147,757	-	-	-	-	147,757
Total financial assets	**240,136**	**-**	**-**	**-**	**-**	**240,136**
FINANCIAL LIABILITIES						
Borrowings	258,652	31,932	231,809	960,343	391,140	1,873,876
Trade and other payables	36,996	-	23,505	164,537	-	225,038
Finance lease obligations	7,642	3,469	10,522	63,411	11,510	96,554
Total interest bearing financial liabilities	**303,290**	**35,401**	**265,836**	**1,188,291**	**402,650**	**2,195,468**
Trade and other payables	158,161	2,950	-	10,538	-	171,649
Salaries payable	7,294	-	-	-	-	7,294
Total financial liabilities	**468,745**	**38,351**	**265,836**	**1,198,829**	**402,650**	**2,374,411**
Liquidity gap	**(228,609)**	**(38,351)**	**(265,836)**	**(1,198,829)**	**(402,650)**	
Cumulative liquidity gap	**(228,609)**	**(266,960)**	**(532,796)**	**(1,731,625)**	**(2,134,275)**	

The management of the Group plans to cover its negative liquidity gap through attracting new loans from lenders, government support and future operational cash inflows.

	Up to 1 month	1 month to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	December 31, 2015 Total
FINANCIAL ASSETS						
Loans receivable	-	-	77,581	-	-	77,581
Trade and other receivables	66,160	-	-	-	-	66,160
Cash and cash equivalents	8,119	-	-	-	-	8,119
Total financial assets	**74,279**	**-**	**77,581**	**-**	**-**	**151,860**
FINANCIAL LIABILITIES						
Borrowings	19,466	49,111	156,375	572,840	161,071	958,863
Trade and other payables	5,868	-	33,986	158,320	-	198,174
Finance lease obligations	1,094	1,792	12,615	59,620	22,210	97,331
Total interest bearing financial liabilities	**26,428**	**50,903**	**202,976**	**790,780**	**183,281**	**1,254,368**
Trade and other payables	124,249	22,129	4,627	-	-	151,005
Salaries payable	6,230	-	-	-	-	6,230
Total financial liabilities	**156,907**	**73,032**	**207,603**	**790,780**	**183,281**	**1,411,603**
Liquidity gap	**(82,628)**	**(73,032)**	**(130,022)**	**(790,780)**	**(183,281)**	
Cumulative liquidity gap	**(82,628)**	**(155,660)**	**(285,682)**	**(1,076,462)**	**(1,259,743)**	

(In thousands of Azerbaijani Manats unless otherwise indicated)

Asset and liability maturity periods and the ability to replace interest liabilities at an acceptable cost when they mature, are crucial in determining the Group's liquidity and its susceptibility to fluctuations in interest rates and exchange rates.

A further analysis of the liquidity and interest rate risks is presented in the following tables in accordance with IFRS 7. The amounts disclosed in these tables do not correspond to the amounts recorded on the statement of financial position as the presentation below includes a maturity analysis for financial liabilities that indicates the total remaining contractual payments (including interest payments), which are not recognized in the statement of financial position under the effective interest rate method.

The maturity analysis of financial liabilities at December 31, 2016 is as follows:

	Demand and less than 1 month	From 1 to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Total
FINANCIAL LIABILITIES						
Borrowings	262,847	40,206	267,317	1,014,638	438,976	2,023,984
Trade and other payables	40,746	7,501	57,261	264,678	-	370,186
Finance lease obligations	9,953	4,788	14,053	75,067	12,604	116,465
Total interest bearing financial liabilities	**313,546**	**52,495**	**338,631**	**1,354,383**	**451,580**	**2,510,635**
Trade and other payables	158,161	2,950	-	10,538	-	171,649
Salaries payable	7,294	-		-	-	7,294
Total potential future payments for financial obligations	**479,001**	**55,445**	**338,631**	**1,364,921**	**451,580**	**2,689,578**

The maturity analysis of financial liabilities at December 31, 2015 is as follows:

	Demand and less than 1 month	From 1 to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Total
FINANCIAL LIABILITIES						
Borrowings	22,354	54,674	178,317	615,665	171,889	1,042,899
Trade and other payables	5,966	-	35,119	393,950	-	435,035
Finance lease obligations	1,654	4,278	16,886	73,637	25,083	121,538
Total interest bearing financial liabilities	**29,974**	**58,952**	**230,322**	**1,083,252**	**196,972**	**1,599,472**
Trade and other payables	124,249	22,129	4,627	-	-	151,005
Salaries payable	6,230	-		-	-	6,230
Total potential future payments for financial obligations	**160,453**	**81,081**	**234,949**	**1,083,252**	**196,972**	**1,756,707**

(In thousands of Azerbaijani Manats unless otherwise indicated)

Market risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risk: interest rate risk, currency risk and other price risk, such as equity price risk and commodity risk. Financial instruments affected by market risk include loans and borrowings, deposits, available-for-sale investments and derivative financial instruments.

Interest rate risk

The Group takes on exposure to the effects of fluctuations in the prevailing levels of market interest rates on its financial position and cash flows. Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Group's exposure to the risk of changes in market interest rates relates primarily to the Group's long-term debt obligations with floating interest rates.

The Group borrows on both a fixed and variable rate basis and has other interest-bearing liabilities. The Group incurs interest rate risk on liabilities with variable interest rate.

Impact on loss before income tax:

	As at December 31, 2016		As at December 31, 2015	
	Interest rate +1%	Interest rate −1%	Interest rate +1%	Interest rate −1%
FINANCIAL LIABILITIES				
Borrowings	(18,739)	18,739	(9,589)	9,589
Trade and other payables	(2,250)	2,250	(1,982)	1,982
Finance lease obligations	(966)	966	(973)	973
Net impact on loss before income tax	**(21,955)**	**21,955**	**(12,544)**	**12,544**

Currency risk

The currency risk is the risk of losses due to adverse changes in foreign exchange rates with regard to the Group's assets and liabilities denominated in foreign currencies.

The Group maintains centralized currency risk management system, which establishes risk policy towards certain currencies and prescribes regular analysis of foreign currency risk exposure. This analysis includes the assessment of open foreign exchange position, forecast modeling of exchange rates and the analysis of deviations between forecast and budget rates.

The Group aims at maintaining a neutral open foreign exchange position through offset of outflows in a foreign currency by inflows in corresponding currency.

The Group is exposed to currency risk on selected receivables, payables and borrowings that are denominated in a currency other than the Group's functional currency. The currencies in which these transactions are denominated are primarily the US dollars, GEL, CHF, EUR and KZT.

The Group's exposure to foreign currency exchange rate risk is presented in the table below:

(In thousands of Azerbaijani Manats unless otherwise indicated)

	AZN	USD	GEL	EUR	KZT	CHF	December 31, 2016 Total
FINANCIAL ASSETS							
Loans receivable	-	60,817	-	-	-	-	60,817
Trade and other receivables	31,053	319	165	-	25	-	31,562
Cash and cash equivalents	9,801	118,821	322	18,704	-	109	147,757
TOTAL FINANCIAL ASSETS	**40,854**	**179,957**	**487**	**18,704**	**25**	**109**	**240,136**
FINANCIAL LIABILITIES							
Borrowings	7,779	864,283	-	1,001,814	-	-	1,873,876
Finance lease obligations	-	56,246	-	-	40,308	-	96,554
Trade and other payables	34,591	60,449	25,796	225,456	2,142	48,253	396,687
Salaries payable	6,497	-	797	-	-	-	7,294
TOTAL FINANCIAL LIABILITIES	**48,867**	**980,978**	**26,593**	**1,227,270**	**42,450**	**48,253**	**2,374,411**
OPEN CURRENCY POSITION	**(8,013)**	**(801,021)**	**(26,106)**	**(1,208,566)**	**(42,425)**	**(48,144)**	

	AZN	USD	GEL	EUR	KZT	CHF	December 31, 2015 Total
FINANCIAL ASSETS							
Loans receivable	-	77,581	-	-	-	-	77,581
Trade and other receivables	20,605	44,762	793	-	-	-	66,160
Cash and cash equivalents	4,906	2,094	1,119	-	-	-	8,119
TOTAL FINANCIAL ASSETS	**25,511**	**124,437**	**1,912**	**-**	**-**	**-**	**151,860**
FINANCIAL LIABILITIES							
Borrowings	66,315	662,329	600	229,619	-	-	958,863
Finance lease obligations	-	60,369	-	-	36,962	-	97,331
Trade and other payables	34,487	32,225	37,381	198,175	-	46,911	349,179
Salaries payable	5,419	-	811	-	-	-	6,230
TOTAL FINANCIAL LIABILITIES	**106,221**	**754,923**	**38,792**	**427,794**	**36,962**	**46,911**	**1,411,603**
OPEN CURRENCY POSITION	**(80,710)**	**(630,486)**	**(36,880)**	**(427,794)**	**(36,962)**	**(46,911)**	

Currency risk sensitivity

The following tables detail the Group's sensitivity to a 10 % increase and decrease in the respective currencies with regard to its net monetary position against the AZN. 10 % is the sensitivity rate used when reporting foreign currency risk internally to key management personnel and represents management's assessment of the possible change in foreign currency exchange rates. The sensitivity analysis includes only outstanding foreign currency denominated monetary items and adjusts their translation at the end of the period for a 10% change in foreign currency rates. A positive number below indicates an increase in profit and other equity where the AZN strengthens 10% against the relevant currency. For a 10% weakening of the AZN against the relevant currency, there would be a comparable impact on the profit and other equity, and the balances below would be negative.

(In thousands of Azerbaijani Manats unless otherwise indicated)

	December 31, 2016		December 31, 2015	
	Change in exchange rate	Net impact on loss before income tax	Change in exchange rate	Net impact on loss before income tax
AZN/USD	10%	(80,102)	10%	(63,049)
	-10%	80,102	-10%	63,049
AZN/GEL	10%	(2,611)	10%	(3,688)
	-10%	2,611	-10%	3,688
AZN/EUR	10%	(120,857)	10%	(42,779)
	-10%	120,857	-10%	42,779
AZN/KZT	10%	(4,243)	10%	(3,696)
	-10%	4,243	-10%	3,696
AZN/CHF	10%	(4,814)	10%	(4,691)
	-10%	4,814	-10%	4,691

34. FAIR VALUE OF FINANCIAL INSTRUMENTS

As at December 31, 2016 and 2015 the Group had no financial instruments measured at fair value.

The following table sets out the fair values of financial instruments not measured at fair value and analyses them by the level in the fair value hierarchy into which each fair value measurement is categorized.

		Fair value measurement using			
	Date of valuation	Quoted prices in active markets (Level 1)	Significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)	December 31, 2016 Total
Assets for which fair values are disclosed					
Cash and cash equivalents	December 31, 2016	147,757	-	-	**147,757**
Loans receivable	December 31, 2016	-	-	60,817	**60,817**
Trade and other receivables	December 31, 2016	-	-	31,562	**31,562**
Liabilities for which fair values are disclosed					
Borrowings	December 31, 2016	-	-	1,873,876	**1,873,876**
Finance lease obligations	December 31, 2016	-	-	96,554	**96,554**
Trade and other payables	December 31, 2016	-	-	396,687	**396,687**
Salaries payable	December 31, 2016	-	-	7,294	**7,294**

(In thousands of Azerbaijani Manats unless otherwise indicated)

	Date of valuation	Fair value measurement using			
		Quoted prices in active markets (Level 1)	Significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)	December 31, 2015 Total
Assets for which fair values are disclosed					
Cash and cash equivalents	December 31, 2015	8,119	-	-	**8,119**
Loans receivable	December 31, 2015	-	-	77,581	**77,581**
Trade and other receivables	December 31, 2015	-	-	66,160	**66,160**
Liabilities for which fair values are disclosed					
Borrowings	December 31, 2015	-	-	958,863	**958,863**
Finance lease obligations	December 31, 2015	-	-	97,331	**97,331**
Trade and other payables	December 31, 2015	-	-	349,179	**349,179**
Salaries payable	December 31, 2015	-	-	6,230	**6,230**

Fair value of financial assets and liabilities not carried at fair value

Set out below is a comparison by class of the carrying amounts and fair values of the Company's financial instruments that are not carried at fair value in the statement of financial position. The table does not include the fair values of non-financial assets and non-financial liabilities.

	Carrying value 2016	Fair value 2016	Unrecognized gain/(loss) 2016	Carrying value 2015	Fair value 2015	Unrecognized gain/(loss) 2015
Financial assets						
Cash and cash equivalents	147,757	147,757	-	8,119	8,119	-
Loans receivable	60,817	60,817	-	77,581	77,581	-
Trade and other receivables	31,562	31,562	-	66,160	66,160	-
Financial liabilities						
Borrowings	1,873,876	1,873,876	-	958,863	958,863	-
Finance lease obligations	96,554	96,554	-	97,331	97,331	-
Trade and other payables	396,687	396,687	-	349,179	349,179	-
Salaries payable	7,294	7,294	-	6,230	6,230	-
Total unrecognized change in unrealized fair value			-			-

Assets and liabilities for which fair value approximates carrying value

For financial assets and financial liabilities that are liquid or having a short term maturity (less than three months) it is assumed that the carrying amounts approximate to their fair value. This assumption is also applied to demand deposits, without a specific maturity and variable rate financial instruments.

Fixed and variable rate financial instruments

For quoted debt instruments the fair values are determined based on quoted market prices. The fair values of unquoted debt instruments are estimated by discounting future cash flows using rates currently available for debt on similar terms, credit risk and remaining maturities.

35. EVENTS AFTER THE REPORTING PERIOD

Amendments of borrowing agreements

BNP Paribas (Suisse) S.A.

On April 21, 2017 the Group signed an amendment to the agreement with BNP Paribas (Suisse) S.A. According to the amendment, grace period granted till July 2018 and monthly principal payments reduced from USD 2,600 thousand to USD 1,000 thousand starting from July 2018. The Group will make bulk repayment in the amount of USD 35,500 thousand on February 2020. The new effective interest rate is 5%.

"International Bank of Azerbaijan" OJSC

On April 28, 2017 the Group signed an amendment to the agreement with "International Bank of Azerbaijan" OJSC. According to the amendment, loans dominated in USD as at December 31, 2016 were consolidated as a single loan. The Group will repay interest on annual basis and bulk principal repayment will be made at the end of 3 years grace period. The new effective interest rate is 4%.

On April 28, 2017 the Group also signed a credit agreement with "International Bank of Azerbaijan" OJSC for the amount of EUR 200,000 thousand. On July 27, 2017, the Group signed an addendum to the main agreement and the loan maturity date was amended to September 28, 2017. The loan bears annual interest rate of 1.25%.

"Azer Turk Bank" OJSC

On April 28, 2017 the Group refinanced the loan from "Azer Turk Bank" OJSC and consolidated with debts of "International Bank of Azerbaijan" OJSC.

"Kapital Bank" OJSC

On July 4, 2017 the Group signed an amendment to the agreement with "Kapital Bank" OJSC. According to the amendment, all loans dominated in USD as at December 31, 2016 were consolidated as a single loan. The Group will repay monthly interest and bulk principal repayment will be made after 2 years from restructuring date. The new effective interest rate is 4.6%.

VTB Bank Austria

On February 28 and July 13, 2017 the Group signed an amendments to the agreement with VTB Bank Austria. According to the amendments, monthly principal payments reduced from USD 3,600 thousand to USD 1,000 thousand. The Group will make bulk repayment in the amount of USD 25,000 thousand on February 2019. The new effective interest rate is 5.75%.

The Group complied with financial covenants stipulated in the amendments as at December 31, 2016.

Opening of new railway line from Azerbaijan to Iran

On March 2017 the Group made opening of new 8.3 km railway line and the bridge between Astara Azerbaijan and Astara Iran.

Abolishment of sub-departments

Several organizations under the subordination of "Azerbaijan Railways" CJSC have been abolished.

Ganja Railway Hygiene and Epidemiology Center, Yevlakh Railway Ambulatory, Kurdamir Railway Ambulatory and Anti-Town Station under the subordination of the Medical-Sanitary Service of "Azerbaijan Railways" CJSC announced their abolishment.

In addition, Lankaran Railway Ambulatory, Ujar Railway Ambulatory, Mincivan Railway Hospital, Hajigabul Railway Hospital, Salyan Line Hospital, Imishli Railway Epidemiology Hygiene Center were also abolished.

Establishment of new subsidiary

The Group has established a property management company "ADY Real Estate" LLC. The company was founded in April, 2017 with initial capital of AZN 200 and is located in the company's administrative building.

The Group also established "ADY Container" Ltd. providing international standard logistics services via transport corridors. The Company was founded in June 2017 with initial capital of AZN 50 thousand and is 100% subsidiary of "Azerbaijan Railways" CJSC.

Registration of government investments as share capital

On August, 2017, the Cabinet of Ministers of the Republic of Azerbaijan introduced an amendment to the resolution on approval of the charter and structure of the Group, dated February 15, 2010.

Authorized share capital of the Group increased by AZN 79,915 thousand or 11% up to AZN 806,062 thousand. Accordingly, the number of the Group shares in circulation with face value of AZN 2 each, increased by 39,958 thousand units and equalled to AZN 403,031 thousand.